Valley Farm Credit, ACA

SECOND QUARTER 2006

Robert N. Carpenter
Chief Executive Officer

Charles W. Kackley
Chairman of the Board

August 9, 2006

Valley Farm Credit, ACA

Management's Discussion and Analysis of Financial Condition and Results of Operations

(dollars in thousands)

The following commentary reviews the financial condition and results of the consolidated operations of Valley Farm Credit, ACA, Valley Farm Credit, FLCA and Valley Farm Credit, PCA (Association) for the period ended June 30, 2006. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements, and the 2005 Annual Report of the Association. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners, and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans. The Association's loan portfolio is diversified over a range of agricultural commodities in our region, including livestock, poultry, beef, orchards, dairy and rural home loans. Those major farm commodities totaled approximately $123,026 or 65.44% of the loan volume as of June 30, 2006. Farm size varies and many of the borrowers in the region have diversified farming operations. This factor, along with the numerous opportunities for non-farm income in the area, somewhat impacts the level of dependency on a given commodity.

The gross loan volume of the Association as of June 30, 2006 was $170,765, an increase of $8,577 as compared to $162,188 at December 31, 2005. Net loans outstanding at June 30, 2006 were $170,096 as compared to $161,478 at December 31, 2005. Net loans accounted for 91.79 percent of total assets at June 30, 2006 as compared to 91.37 percent of total assets at December 31, 2005. The increase in gross and net loan volume during the reporting period is attributed primarily to new loans to several different sectors of the Association's agricultural portfolio, new loans to the residential portion of the portfolio, participation loans purchased and repurchasing a portion of a block of loans previously sold to the AgFirst Farm Credit Bank to enhance the Association's liquidity ratio.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level, and credit administration remains satisfactory. Nonaccrual loans were $0 at June 30, 2006 and December 31, 2005. Association management maintains an allowance for loan losses in an amount sufficient to absorb losses inherent in the loan portfolio at the balance sheet date based on current conditions. The allowance for loan losses was $669 at June 30, 2006 and $710 at December 31, 2005, and was considered by management to be adequate.

RESULTS OF OPERATIONS

For the three months ended June 30, 2006

Net income for the three months ended June 30, 2006, totaled $300, as compared to $949 for the same period in 2005. Net interest income increased $5 for the three months ended June 30, 2006 as compared to the same period in 2005.

At June 30, 2006 interest income on loans increased $260 as compared to the same period in 2005. Nonaccrual income was $0 for the three months ended June 30, 2006 and for the same period in 2005. Interest expense increased $255 for the three months ended June 30, 2006 as compared to the same period in 2005. There was a reversal of allowance for loan losses for the three months ended June 30, 2006 of $28 as compared to $0 for the same period in 2005. Noninterest income for the three months ended June 30, 2006 totaled $765 as compared to $1,222 for the same period of 2005, a decrease of $457. Total noninterest income for the three month period ended June 30, 2005 included the gain on sale of assets in the amount of $507, which was related to the sale of property located in Martinsburg, WV. Noninterest expense for the three months ended June 30, 2006 increased $225 compared to the same period of 2005. There was no provision (benefit) for income taxes at June 30, 2006 or the same period in 2005.

For the six months ended June 30, 2006

Net income for the six months ended June 30, 2006, totaled $366, as compared to $1,229 for the same period in 2005. Net interest income increased $22 for the six months ended June 30, 2006 as compared to the same period in 2005.

At June 30, 2006 interest income on loans increased $489 as compared to the same period in 2005. Nonaccrual income was $0 for the six months ended June 30, 2006 and for the same period in 2005. Interest expense increased $467 for the six months ended June 30, 2006 as compared to the comparable period of 2005. There was a reversal of allowance for loan losses for the six months ended June 30, 2006 of $41 as compared to $0 for the same period in 2005. Noninterest income for the six months ended June 30, 2006 totaled $1,394 as compared to $1,881 for the same period in 2005, a decrease of $487. Total noninterest income for the six month period ended June 30, 2005 included the gain on sale of assets in the amount of $507, which was related to the sale of property located in Martinsburg, WV. Noninterest expense for the six months ended June 30, 2006 increased $439 compared to the same period in 2005. The increase during the reporting period is mostly attributed to additional staffing, increased occupancy and equipment expenses and increased insurance fund expenses. There was no provision (benefit) for income taxes at June 30, 2006 or the same period in 2005.

FUNDING SOURCES

The principal source of funds for the Association is the borrowing relationship established with the AgFirst Farm Credit Bank (the Bank) through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The funds are advanced by the Bank to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at June 30, 2006 was $158,631 as compared to $149,339 at December 31, 2005. The increase during the period is primarily attributed to an increase in loan volume.

CAPITAL RESOURCES

Total members' equity at June 30, 2006 increased to $23,312 from the December 31, 2005 total of $23,180. The rise in members' equity is attributed to the increase in retained earnings in excess of the reduction in capital stock and participation certificates.

Total capital stock and participation certificates were $3,991 on June 30, 2006 compared to $3,960 on December 31, 2005. This increase is attributed to an excess of stock purchases above the normal retirement of stock on loans liquidated in the normal course of business.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus and core surplus as defined in FCA regulations, by a risk-adjusted asset base. As of June 30, 2006, the Association's total surplus ratio and core surplus ratio were 12.14 percent and 11.15 percent, respectively, and the permanent capital ratio was 15.00 percent. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

NOTE: Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 316, or writing Wanda Martin, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, *www.agfirst.com*. Copies of the Association's annual and quarterly reports are also available upon request free of charge by calling 1-800-999-5341 or writing Mary S. Miller, Vice President and CFO, Valley Farm Credit, ACA, P.O. Box 2700, Winchester, Virginia 22604, or accessing the website, ***www.valleyfc.com***. The Association prepares a quarterly report within 45 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

Valley Farm Credit, ACA

Consolidated Balance Sheets

(dollars in thousands)	June 30, 2006 *(unaudited)*	December 31, 2005 *(audited)*
Assets		
Cash	$ 674	$ 602
Loans	170,765	162,188
Less: allowance for loan losses	669	710
Net loans	170,096	161,478
Accrued interest receivable	1,408	1,165
Investment in other Farm Credit institutions	2,173	2,173
Premises and equipment, net	8,053	6,933
Prepaid retirement expense	1,739	1,963
Due from AgFirst Farm Credit Bank	600	1,745
Other assets	558	669
Total assets	$ 185,301	$ 176,728
Liabilities		
Notes payable to AgFirst Farm Credit Bank	$ 158,631	$ 149,339
Accrued interest payable	692	594
Patronage refund payable	12	121
Postretirement benefits other than pensions	943	897
Other liabilities	1,711	2,597
Total liabilities	161,989	153,548
Commitments and contingencies		
Members' Equity		
Capital stock and participation certificates	3,991	3,960
Retained earnings		
Allocated	3,888	4,203
Unallocated	15,433	15,017
Total members' equity	23,312	23,180
Total liabilities and members' equity	$ 185,301	$ 176,728

The accompanying notes are an integral part of these financial statements.

Valley Farm Credit, ACA

Consolidated Statements of Income

(unaudited)

(dollars in thousands)	For the three months ended June 30, 2006	For the three months ended June 30, 2005	For the six months ended June 30, 2006	For the six months ended June 30, 2005
Interest Income				
Loans	$ 3,008	$ 2,748	$ 5,892	$ 5,403
Interest Expense				
Notes payable to AgFirst Farm Credit Bank	2,021	1,766	3,926	3,459
Net interest income	987	982	1,966	1,944
Provision for (reversal of allowance for) loan losses	(28)	—	(41)	—
Net interest income after provision for (reversal of allowance for) loan losses	1,015	982	2,007	1,944
Noninterest Income				
Loan fees	89	104	154	154
Fees for financially related services	36	30	62	48
Equity in earnings of other Farm Credit institutions	304	293	604	583
Gains (losses) on sale of rural home loans	264	264	472	526
Gain on sale of assets	14	507	6	507
Other noninterest income	58	24	96	63
Total noninterest income	765	1,222	1,394	1,881
Noninterest Expense				
Salaries and employee benefits	867	781	1,834	1,634
Occupancy and equipment	198	138	390	268
Insurance Fund premium	57	15	112	31
Other operating expenses	358	321	699	663
Total noninterest expense	1,480	1,255	3,035	2,596
Income before income taxes	300	949	366	1,229
Provision (benefit) for income taxes	—	—	—	—
Net income	$ 300	$ 949	$ 366	$ 1,229

The accompanying notes are an integral part of these financial statements.

Valley Farm Credit, ACA

Consolidated Statements of Changes in Members' Equity

(unaudited)

(dollars in thousands)	Capital Stock and Participation Certificates	Retained Earnings Allocated	Retained Earnings Unallocated	Total Members' Equity
Balance at December 31, 2004	$ 3,924	$ 4,388	$ 12,885	$ 21,197
Net income			1,229	1,229
Capital stock/participation certificates issued	162			162
Capital stock/participation certificates retired	(183)			(183)
Retained earnings retired		(550)		(550)
Distribution adjustment		(54)	78	24
Balance at June 30, 2005	$ 3,903	$ 3,784	$ 14,192	$ 21,879
Balance at December 31, 2005	$ 3,960	$ 4,203	$ 15,017	$ 23,180
Net income			366	366
Capital stock/participation certificates issued	150			150
Capital stock/participation certificates retired	(119)			(119)
Retained earnings retired		(275)		(275)
Distribution adjustment		(40)	50	10
Balance at June 30, 2006	$ 3,991	$ 3,888	$ 15,433	$ 23,312

The accompanying notes are an integral part of these financial statements.

Valley Farm Credit, ACA

Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)
(unaudited)

NOTE 1 – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

A description of the organization and operations of Valley Farm Credit, ACA (the Association), the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2005, are contained in the 2005 Annual Report to Shareholders. These unaudited second quarter 2006 consolidated financial statements should be read in conjunction with the 2005 Annual Report to Shareholders.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles. The results for the six months ended June 30, 2006, are not necessarily indicative of the results to be expected for the year ending December 31, 2006.

Certain amounts in prior period consolidated financial statements have been reclassified to conform to current consolidated financial statement presentation. Such reclassifications had no effect on the prior period net income or total capital as previously reported.

The Association maintains an allowance for loan losses in accordance with generally accepted accounting principles. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of June 30, 2006, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

NOTE 2 – ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses follows:

Balance at 12-31-04	$ 828
(Reversal of) provision for loan losses	–
Recoveries, net of loans charged off	–
Balance at 6-30-05	$ 828
Balance at 12-31-05	$ 710
(Reversal of) provision for loan losses	(41)
Recoveries, net of loans charged off	–
Balance at 6-30-06	$ 669

NOTE 3 – EMPLOYEE BENEFIT PLANS

The Association participates in a Districtwide defined benefit retirement plan. The costs of the plan are not segregated by participating entities but are allocated among the participating entities. Pension costs are allocated by multiplying the District's net pension expense times each institution's salary expense as a percentage of the District's salary expense. The Association also participates in Districtwide Thrift and other postretirement benefit plans.

The following is a table of retirement and postretirement benefit expense for the six months ended June 30, 2006:

	For the six months ended June 30,	
	2006	**2005**
Pension	$ 224	$ 199
Thrift/deferred compensation	74	66
Other postretirement benefits	65	88
Total	$ 363	$ 353

As of June 30, 2006, no contributions have been made to the pension plan for 2006. Actuarial projections as of the last plan measurement date (September 30, 2005) did not anticipate any contributions for 2006; however, market conditions could impact discount rates and return on plan assets which could change this expectation, making contributions necessary before the next plan measurement date.