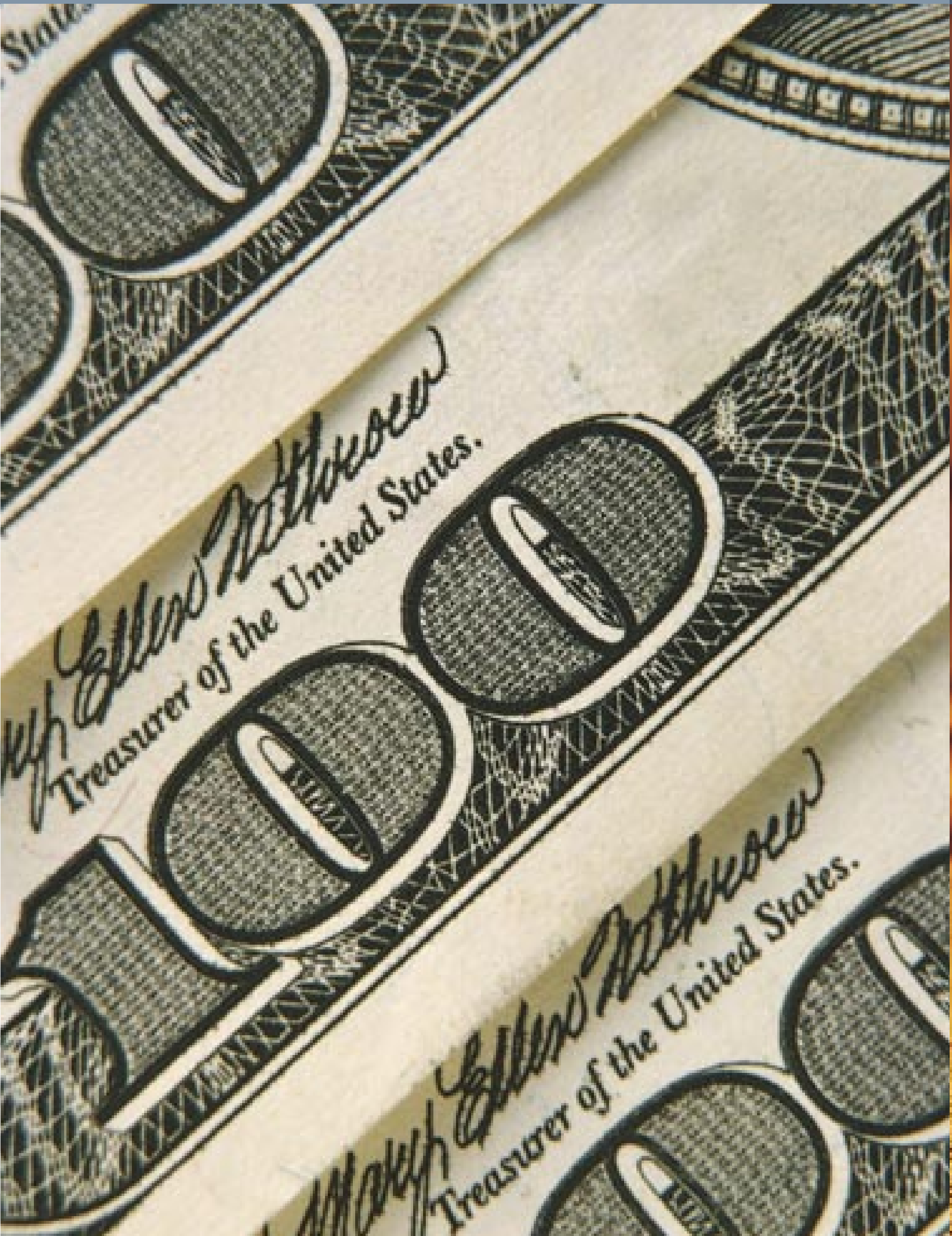
Valley Farm Credit

ANNUAL REPORT 2004



VALLEY FARM CREDIT, ACA

2004 ANNUAL REPORT

Contents

Management

Robert N. Carpenter .... President and Chief Executive Officer
Luther O. Stiles .... Executive Vice President and Chief Administrative Officer
Scott K. Swaim .... Senior Vice President – Credit
Allan K. George .... Senior Vice President – Lending Programs
Stephen T. Grant .... Vice President – Member Services
Jeffrey B. Michael .... Senior Vice President – Residential Lending
Mary S. Miller .... Vice President – Chief Financial Officer
Ruth C. M. Boden .... Vice President – Branch Manager
Cheryl G. Keesecker .... Vice President – Branch Manager

Board of Directors

Charles W. Kackley .... Chairman
John P. Burns, Jr. .... Vice Chairman
Gary W. Bushong. .... Director
T. Jeffery Jennings .... Director
Harry M. Kable .... Director
Jim A. Long .... Director
Charles W. Orndoff, Sr. .... Director
Betty H. Carroll .... Outside Director

Message from the President

Valley Farm Credit is pleased to report that its 2004 operating year was successful. The Rural Lending Division (farm loans) had another outstanding growth year in loan volume. The Residential Lending Division (home loans) had less activity in 2004 due to the refinance market subsiding. Operating income was down slightly from our budget forecast, although net income reached $3,607,225.

Our commitment to agriculture and the area's farm families has not diminished. Loan assets were $171,768,357 at December 31, 2004 for agriculture, part-time farm, and residential loans. Business activity in 2004 exceeded our business plan expectations. Loans in the farm division were up 11.97% from 2003. Loan demand was diversified and came from all branches. Commercial farm and part-time farm loan growth was complimented by residential construction lending.

The residential group had another productive year. Originations of home loans held for sale amounted to $54,283,620. The level of activity was less than 2003, which experienced an unusually high demand for refinance activity. Total loans originated in 2004 exceeded $85,000,000 in the Residential Division. The difference between the loans sold and originated is primarily made up of construction financing currently within the Valley Farm Credit residential loan portfolio, and will be sold into the secondary market upon completion of the construction.

Business goals for 2005 have been set to reflect continued growth in the portfolio and commitment to member service. Portfolio growth is expected to be in the range of 6% in 2005. Growth opportunities in the residential division are expected to remain strong, with loans sold expected to reach $96,000,000.

The board has maintained its review of capital level requirements for 2005 based upon the highly successful loan growth of 2004. The adoption of a capital planning model has provided guidance in establishing realistic capital objectives. A block of loans amounting to $14,000,000 was offered to the Farmer Mac Corporation (a federal Government Sponsored Entity (GSE) guarantor) to provide capital improvement to ensure the association is adequately capitalized. These loans remain within the association's portfolio and continue to be serviced by the association. The guarantee offers capital relief without placing an unnecessary burden upon the members of the cooperative. The board has established the permanent capital ratio to be in a range of 12 – 14%.

The Association has a well-diversified portfolio with significant benefits to members from farm and non-farm income to support loan repayments. Loan delinquencies remain well within industry standards and pose no significant risk to the Association. Loan charge-offs have been negligible. There were no non-accruing assets during 2004.

The loan economy has remained strong over the past several years. Unemployment remains below state and national averages for the Association territory. It is expected this trend will continue as the local region experiences continued residential and business growth. Favorable interest rates have provided stability to the lending environment and aided farm producers with lower costs as a result of lower total interest expense. We expect business results for the Association in 2005 to remain strong.

During the fourth quarter 2004, the association followed a System-wide endeavor to refine the Allowance for Loan Losses (ALL) under a directive from the Farm Credit Administration (FCA). A reversal of $2,000,000 from the ALL was taken into income and placed in Unallocated Surplus leaving an allowance of $828,000. Historical loan losses over the prior eight years have been negligible.

The Association was fortunate to add more qualified staff in 2004. Growth in assets and the successful secondary market program contributed to the need for a continued search for experienced staff. Portfolio assets have grown by more than 58% in the past five years. The Residential Division growth has been even more significant. Staff numbers have increased by 55% in the past five years to accommodate the increased loan activity. Commitment to service and offering of products of importance to the membership remains our top priority.

The association formed a new entity in December 2004. Valley Farm Credit, LLLP was registered with the State Corporation Commission for the purpose of processing title insurance services for the membership. This service will be contracted through Cameron Title, LLC of Winchester and underwritten by Lawyer's Title Insurance Corporation of Richmond. The service falls under the financially related service section of Farm Credit Administration Regulations. This limited liability partnership, owned by Valley Farm Credit, FLCA, as the limited partner, and Valley Farm Credit, ACA, as the general partner, will provide service beginning in early 2005 to borrowers opting to purchase their title insurance through Valley Farm Credit, LLLP.

Robert N. Carpenter
President/Chief Executive Officer

March 2, 2005

Report of Management

The accompanying consolidated financial statements and related financial information appearing throughout this annual report have been prepared by management of Valley Farm Credit, ACA (the Association) in accordance with generally accepted accounting principles appropriate in the circumstances. Amounts which must be based on estimates represent the best estimates and judgments of management. Management is responsible for the integrity, objectivity, consistency, and fair presentation of the consolidated financial statements and financial information contained in this report.

Management maintains and depends upon an internal accounting control system designed to provide reasonable assurance that transactions are properly authorized and recorded, that the financial records are reliable as the basis for the preparation of all financial statements, and that the assets of the Association are safeguarded. The design and implementation of all systems of internal control are based on judgments required to evaluate the costs of controls in relation to the expected benefits and to determine the appropriate balance between these costs and benefits. The Association maintains an internal audit program to monitor compliance with the systems of internal accounting control. Audits of the accounting records, accounting systems and internal controls are performed and internal audit reports including appropriate recommendations for improvement, are submitted to the Board of Directors.

The consolidated financial statements have been examined by independent public auditors, whose report appears elsewhere in this annual report. The Association is also subject to examination by the Farm Credit Administration.

The consolidated financial statements, in the opinion of management, fairly present the financial condition of the Association. The undersigned certify that the 2004 Annual Report has been prepared in accordance with all applicable statutory or regulatory requirements and that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Charles W. Kackley
Chairman of the Board

Robert N. Carpenter
Chief Executive Officer

Mary S. Miller
Chief Financial Officer

March 2, 2005

Consolidated Five - Year Summary of Selected Financial Data

(UNAUDITED)

(dollars in thousands)	2004	2003	December 31, 2002	2001	2000
Balance Sheet Data					
Cash	$ 381	$ 706	$ 211	$ 612	$ 364
Loans	171,768	153,411	137,434	126,075	108,235
Less: allowance for loan losses	828	2,826	2,773	2,547	2,348
Net loans	170,940	150,585	134,661	123,528	105,887
Investment in AgFirst Farm Credit Bank	2,061	1,393	1,393	1,393	1,393
Other assets	8,875	5,639	5,799	5,285	5,719
Total assets	$ 182,257	$ 158,323	$ 142,064	$ 130,818	$ 113,363
Notes payable to AgFirst Farm Credit Bank*	$ 157,765	$ 137,721	$ 122,606	$ 112,024	$ 95,076
Accrued interest payable and other liabilities with maturities of less than one year	3,295	3,626	3,346	1,869	1,986
Total liabilities	161,060	141,347	125,952	113,893	97,062
Protected borrower equity					
Capital stock and participation certificates	3,924	3,872	3,896	3,939	4,028
Retained earnings					
Allocated	4,388	4,360	4,343	4,355	4,658
Unallocated	12,885	10,066	9,400	8,631	7,615
Accumulated other comprehensive income (loss)	—	(1,322)	(1,527)	—	—
Total members' equity	21,197	16,976	16,112	16,925	16,301
Total liabilities and members' equity	$ 182,257	$ 158,323	$ 142,064	$ 130,818	$ 113,363
Statement of Income Data					
Net interest income	$ 3,517	$ 3,119	$ 2,661	$ 2,366	$ 2,462
Provision for (reversal of) loan losses	(2,000)	50	229	221	45
Noninterest income (expense), net	(1,910)	(1,487)	(764)	(634)	(1,335)
Net income	$ 3,607	$ 1,582	$ 1,668	$ 1,511	$ 1,082
Key Financial Ratios					
Rate of return on average:					
Total assets	2.19%	1.08%	1.24%	1.23%	1.00%
Total members' equity	20.55%	9.42%	9.70%	9.04%	6.70%
Net interest income as a percentage of average earning assets	2.20%	2.17%	2.03%	2.00%	2.36%
Net chargeoffs (recoveries) to average loans	(0.001)%	(0.001)%	0.002%	0.02%	—
Total members' equity to total assets	11.63%	10.72%	11.34%	12.94%	14.38%
Debt to members' equity (:1)	7.60	8.33	7.82	6.73	5.95
Allowance for loan losses to loans	0.48%	1.84%	2.02%	2.02%	2.17%
Permanent capital ratio	12.49%	12.58%	13.08%	13.54%	15.15%
Total surplus ratio	9.68%	9.69%	9.83%	9.48%	10.35%
Core surplus ratio	8.39%	8.23%	8.19%	7.74%	8.73%
Net Income Distribution					
Estimated patronage refunds:					
Cash dividend	$ 218	$ 326	$ 270	$ 151	$ 167
Qualified allocated retained earnings	—	—	—	—	389
Nonqualified allocated retained earnings	508	664	630	352	—

* *General financing agreement is renewable on one-year cycle. The next renewal date is December 31, 2005.*

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

(dollars in thousands, except as noted)

GENERAL OVERVIEW

The following commentary summarizes the financial condition and results of operations of Valley Farm Credit, ACA, (Association) for the year ended December 31, 2004 with comparisons to the year ended December 31, 2003. This information should be read in conjunction with the Consolidated Financial Statements, Notes to the Consolidated Financial Statements and other sections in this Annual Report.

The Association is an institution of the Farm Credit System, which was created by Congress in 1916 and has served agricultural producers for almost 90 years. The System mission is to maintain and improve the income and well-being of American farmers, ranchers, and producers or harvesters of aquatic products and farm-related businesses. The Farm Credit System is the largest agricultural lending organization in the United States. The Farm Credit System is regulated by the Farm Credit Administration, (FCA) which is an independent safety and soundness regulator.

The Association is a cooperative, which is owned by the members served. The territory of the Association extends across a diverse agricultural and rural region of five counties in Northern Virginia and three counties in the Eastern Panhandle of West Virginia. Refer to Note 1 of the Notes to the Consolidated Financial Statements for counties in the Association's territory. The Association provides credit to full-time farmers, part-time farmers, rural homeowners, and farm related businesses. Our success begins with our extensive agricultural and residential lending experience and knowledge of the territory served.

The Association obtains funding from AgFirst Farm Credit Bank (the Bank). The Association is materially affected by the financial condition and results of operations of the Bank. Copies of the AgFirst Farm Credit Bank's Quarterly and Annual Reports are on the AgFirst website, ***www.agfirst.com,*** or may be obtained at no charge by calling 1-800-845-1745, extension 378. Copies of the Association's quarterly reports are available on the Association's website, ***www.valleyfc.com,*** or may be obtained upon request free of charge by calling 1-800-999-5341 extension 133 or writing Mary S. Miller, Vice President and CFO, Valley Farm Credit, ACA, P. O. Box 2700, Winchester, Virginia 22604.

ECONOMIC CONDITIONS

During 2004, economic conditions in our region were favorable. Overall, agricultural commodity prices and growing conditions in 2004 were favorable. While grain prices were not as favorable in 2004 and 2003, beef cattle prices remained strong, and milk and poultry prices improved somewhat. Fruit prices remained flat. With respect to the general economy, our region saw another robust year in 2004. Business and residential growth in the eight counties served by the Association are among the highest in Virginia and West Virginia. Unemployment percentages in the Association's counties averaged below state averages. All of these factors contributed to very good loan performance in the Association during 2004.

The Association has positioned itself well in this growth market with expanded loan products and services, along with increased public knowledge of our services to stay ahead of the loan demands in our rural lending markets. While conventional interest rates did rise just over one percent in 2004, rates were still attractive and did not deter loan growth.

LOAN PORTFOLIO

The Association provides loan funds to full-time farmers, part-time farmers, rural homeowners, and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans through numerous product types.

The gross loan volume of the Association as of December 31, 2004, was $171,768, an increase of $18,357 or 11.97 percent as compared to $153,411 at December 31, 2003. Net loans outstanding (gross loans net of the allowance for loan losses) on December 31, 2004, were $170,940 as compared to $150,585 at December 31, 2003. Net loans accounted for 93.79 percent of total assets on December 31, 2004 as compared to 95.11 percent of total assets at December 31, 2003.

The geographic distribution of the loans by branch is as follows:

Branch	12/31/04	12/31/03
Winchester, VA	*40%	*39%
Martinsburg, WV	20	20
Woodstock, VA	40	41
	100%	100%

* *Net of participations sold*

The diversification of the Association volume by loan type is shown below:

Loan Type	12/31/04	12/31/03
Long-term farm mortgage	55.89%	54.89%
Production and intermediate-term	30.07	28.44
Rural home	11.32	12.96
Farm-related business	2.19	2.39
Processing and marketing	.55	.70
Participations purchased	.78	2.35
Less: participations sold	(.80)	(1.73)
	100.00%	100.00%

Commodity concentration within the portfolio is as follows:

	Percent of Portfolio	
Commodity Group	**2004**	**2003**
Poultry	21%	23%
Livestock	25	23
Rural Home	10	12
Orchards	8	8
Dairy	6	7
Part-time & Other	30	27
Total	100%	100%

Commodity groups within the Association's loan portfolio are diversified over four primary groups. Predominant commodities are poultry, livestock, part-time farm and rural home. These four groups represent over 86 percent of the entire portfolio.

Repayment ability within the portfolio is closely related to the agricultural commodities produced by our borrowers and off-farm income for many of the Association's part-time farmers and rural homeowners. Demand for beef and poultry, international trade, and general economic conditions that may impact the local job market are some of the factors that may affect the repayment ability of our predominant borrower types. Even so, the risk in the portfolio associated with commodity concentration is reduced by the range of diversity of enterprises and borrower types in the Association's territory.

Concentration of risk in the loan portfolio, whether by commodity, enterprise, individuals, or related parties, is managed by underwriting standards, internal lending limits, and sound portfolio management and monitoring practices. Please refer to Note 4 in the Notes to the Consolidated Financial Statements section of this Annual Report for additional information concerning the loan types and loan portfolio.

The Association continues to participate in Farm Service Agency (FSA) loan guarantee programs, and in 2004 entered into a Long-Term Standby Commitment program with the Federal Agricultural Mortgage Corporation (Farmer Mac). Under this program, a loan is purchased by Farmer Mac in the event the loan becomes 120 days or more past due, thus allowing the Association to effectively reduce its existing portfolio risk. At December 31, 2004, the Association had loans totaling $11,688 which were 100 percent guaranteed by Farmer Mac, compared to none last year. At December 31, 2004, FSA guaranteed loan volume was $14,503 compared to $12,760 at December 31, 2003.

Another risk management strategy for the Association is the buying and selling of loan participations within and outside the Farm Credit System (FCS). The Association has entered into participation agreements with the Bank and System entities. This provides a means for the Association to spread credit concentration risk and realize non-patronage sourced interest and fee income, which may strengthen their capital position.

Association activity during 2004 with the buying and selling of loan participations within and outside of the FCS is as follows:

Loan Participations:

	2004	2003
Participations Purchased – FCS Institutions	$ 1,336	$ 2,754
Participations Purchased – Non-FCS Institutions	—	848
Participations Sold	(1,372)	(2,667)
Total	$ (36)	$ 935

The Association also sells qualified long-term mortgage residential loans into the secondary market. For the period ended December 31, 2004, the Association originated loans for resale into the secondary market, totaling $54,284, as compared to $89,807 for the previous year. The secondary mortgage market enables the Association to compete in the residential loan market without placing the burden of building capital and generating earnings to support this business on the agricultural sector.

The Association's loan portfolio is divided into performing and high-risk categories. As a part of a system to evaluate the success of each loan, the Association continues to review the credit quality of the loan portfolio on an ongoing basis. The high-risk assets, including accrued interest, are detailed below:

	12/31/04	12/31/03
High-risk Assets		
Nonaccrual loans	$ —	$ —
Restructured loans	—	—
Accruing loans 90 days past due	84	—
Total high-risk loans	84	—
Other property owned	—	—
Total high-risk assets	$ 84	$ —
Ratios		
Nonaccrual loans to total loans	—%	—%
High-risk assets to total assets	0.05%	—%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or interest under the contractual terms of the loan. There were no nonaccrual loans in 2004 or 2003.

Loan restructuring is available to financially distressed borrowers. Restructuring of loans occurs when the Association grants a concession to a borrower based on either a court order or good faith in a borrower's ability to return to financial viability. The concessions can be in the form of a modification of terms or rates, a compromise of amounts owed, or deed in lieu of foreclosure. Other receipts of assets and/or equity to pay the loan in full or in part are also considered restructured loans. The type of alternative financing structure chosen is based on minimizing the loss incurred by both the Association and the borrower.

Credit Quality

We review the credit quality of the loan portfolio on an on-going basis as part of our risk management practices. Each loan is classified according to the Uniform Classification System, which is used by all FCS institutions. Below are the classification definitions.

- *Acceptable* – Assets are expected to be fully collectible and represent the highest quality.
- *Other Assets Especially Mentioned (OAEM)* – Assets are currently collectible but exhibit some potential weakness.
- *Substandard* – Assets exhibit some serious weakness in repayment capacity, equity, and/or collateral pledged on the loan.
- *Doubtful* – Assets exhibit similar weaknesses to substandard assets. However, doubtful assets have additional weaknesses in existing facts, conditions and values that make collection in full highly questionable.
- *Loss* – Assets are considered uncollectible.

The following table presents selected statistics related to the credit quality of loans including accrued interest at December 31.

	2004	2003
Acceptable & OAEM	96.72%	96.49%
Substandard	3.28	3.51
Doubtful	—	—
Loss	—	—
Total	100.00%	100.00%

As a general rule, the substandard portion of the loan portfolio is performing well as is demonstrated by the low amount of volume 90 days past due at year end.

Allowance for Loan Losses

During 2004, the Association completed its study to further refine the allowance for loan losses methodology taking into account recently issued guidance by the FCA, the System's regulator, as well as the Securities and Exchange Commission (SEC) and Federal Financial Institutions Examination Council. As a result of this study and the resulting refinements in methodology, during the fourth quarter of 2004, the Association recorded a $2,000 reversal of the allowance for loan losses.

The Association's allowance for loan losses methodology was adjusted and revised in the late 1980s to take into account the credit losses experienced in the mid-to-late 1980s, as a result of unusually adverse economic factors affecting American agriculture. Given the long cyclical nature of the agricultural economy, loss factors utilized to determine the allowance for loan losses subsequent to 1989 continued to reflect, to some extent, the loss history of the mid-to-late 1980s, which resulted in conservative estimates of the allowance for loan losses. The Association's allowance for loan losses methodology utilized throughout the period was in accordance with generally accepted accounting principles and was consistently applied.

While conservative in estimating the allowance for loan losses, the methodology used resulted in annual provisions for loan losses over the periods that reflected changes in credit quality and loss experience. Accordingly, the reserves provided in the mid-to-late 1980s have, in effect, remained part of the allowance for loan losses. The Association's allowance for loan losses methodology has consistently adhered to proper accounting policies, under the regulatory supervision of the FCA in its role as a "safety and soundness" regulator. It was the FCA's view that the allowance for loan losses should include among others, an assessment of: probable losses, historical loss experience and economic conditions.

In April 2004, the FCA issued an "Informational Memorandum" to System institutions regarding the criteria and methodologies that would be used in evaluating the adequacy of a System institution's allowance for loan losses. The Farm Credit Administration endorsed the direction provided by other bank regulators and the SEC and indicated the conceptual framework addressed in their guidance would be included as part of their examination process.

The refinement in methodology resulted in a calculated allowance for loan losses that was significantly less than the previously recorded balance due to revised loss factors that are more indicative of actual loss experience in recent years and current borrower analysis. The factors considered in determining the revised level of allowance for loan losses were generally based on recent historical charge-off experience adjusted for relevant environmental factors. The Association considered the following when adjusting the historical charge-offs experience:

- changes in credit risk classifications,
- changes in collateral values,
- changes in risk concentrations,
- changes in weather related conditions, and
- changes in economic conditions.

While the reversal had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodology is not expected to have a significant impact on comparative results of operations in future periods. Additionally, the refinement in methodology did not have a significant impact on the level of the risk bearing capacity of the Association, generally referred to as "risk funds" (capital plus the allowance for loan losses), which totaled $22,025 at December 31, 2004 (12.82 percent of Association loans), as compared with $19,802 at December 31, 2003 (12.91 percent of Association loans).

The following table provides relevant information regarding the allowance for loan losses at December 31.

	2004	2003
Allowance for loan losses	$ 828	$ 2,826
Provision for (reversal of) loan losses	(2,000)	50
Net charge-offs/(recoveries)	(2)	(3)
Allowance for loan losses to loans	.48%	1.84%
Allowance for loan losses to nonaccrual loans *	N/A%	N/A%
Allowance for loan losses to impaired loans *	985.71%	N/A%
Net charge-offs/(recoveries) to average loans	(0.001)%	(0.001)%

** There were no nonaccrual loans in 2004 or 2003. There was one impaired loan for $84 in 2004 and none in 2003.*

Please refer to Notes 3 and 4 in the Notes to the Consolidated Financial Statements of this Annual Report for further information concerning the allowance for loan losses, nonaccrual and impaired loans.

EMPLOYEE RETIREMENT PLANS

As of December 31, 2004, the Association had contributed $1,996 to the Districtwide defined benefit retirement plan. The Districtwide funding brings the retirement plan's assets to an amount exceeding the Accumulated Benefit Obligation. The contributions eliminated the minimum pension liability with $541 of the contributions being classified as prepaid retirement expense in other assets on the Consolidated Balance Sheets. Assuming that interest rates and returns on investments remain constant, benefits to the Association in subsequent periods should include improved net income due to lower retirement expense and the elimination of the pension-related charge to accumulated other comprehensive income in the shareholders' equity. See Note 10, Employee Benefit Plans, in the Notes to the Consolidated Financial Statements of the report for further information.

RESULTS OF OPERATIONS

Net income for the year ended December 31, 2004, totaled $3,607, an increase of $2,025 or 128.00 percent, as compared to $1,582 for the same period of 2003. Interest income for the year ended December 31, 2004, was $9,450, an increase of $647 or 7.35 percent as compared to $8,803 for the same period of 2003. Interest income decreased by $345 for the period ended December 31, 2003, compared to December 31, 2002. Major components of the changes in net income for the past two years are outlined in the following table.

Changes in Net Income:

	2004-2003	2003-2002
Net income (prior year)	$ 1,582	$ 1,668
Increase (decrease) in net income due to:		
Interest income	647	(345)
Interest expense	(249)	803
Net interest income	398	458
Provision for loan losses	2,050	179
Noninterest income	(300)	536
Noninterest expense	(228)	(1,035)
Provision for income taxes	105	(224)
Total changes in income	2,025	(86)
Net income	$ 3,607	$ 1,582

Net interest income increased by $398 or 12.76 percent in 2004 compared to 2003. The primary reason for this increase was due to positive growth in loan volume. The Association's net interest income as a percentage of average earning assets was 2.20 percent on December 31, 2004, compared to 2.17 percent on December 31, 2003. The increase is mainly attributed to an increase in loan volume.

Interest income on nonaccrual loans for 2004 totaled $0, a decrease of $5, compared to $5 for 2003. Please refer to the Consolidated Five-Year Summary of Selected Financial Data in this Annual Report to review key financial ratios pertaining to earnings and net interest income. The sources of change in net interest income are illustrated, as follows:

Change in Net Interest Income:

	Volume*	Rate	Nonaccrual Income	Total
12/31/04 - 12/31/03				
Interest income	$ 1,012	$ (360)	$ (5)	$ 647
Interest expense	757	(508)	—	249
Change in net interest income	$ 255	$ 148	$ (5)	$ 398
12/31/03 - 12/31/02				
Interest income	$ 874	$ (984)	$ (235)	$ (345)
Interest expense	609	(1,412)	—	(803)
Change in net interest income	$ 265	$ 428	$ (235)	$ 458

* *Volume variances can be the result of increased/decreased loan volume or from changes in the percentage composition of assets and liabilities between periods.*

A reversal of the provision for loan losses at December 31, 2004 resulted in a balance of $(2,000), compared to provision expense of $50 at December 31, 2003. Please refer to the Allowance for Loan Losses section discussed above.

Noninterest income for the year ended December 31, 2004, was $2,853 as compared to $3,153 the same period of 2003. The decrease is primarily attributed to a decline in revenue from the sale of rural home loans. The Association received $1,082 in a patronage refund and $527 in a special distribution from the Bank for the year ended December 31, 2004 as compared to $957 and $85 respectively for 2003.

Noninterest expense increased $228 or 5.03 percent for December 31, 2004, as compared to the same period of 2003. Salaries and employee benefits which total $2,958 or 62.1 percent of total operating expenses displayed an increase of $50 or 1.72 percent compared to the previous year. Benefits expense for 2004 was $1,152 compared to $1,155 for 2003.

The Association recorded a benefit for income taxes of $1 for the year ended December 31, 2004, as compared to a provision of $104 for 2003. The benefit in 2004 represents the effect of tax adjustments related to the holding company compared to a provision in 2003 which represented an increase in the valuation allowance related to deferred tax assets.

A key factor in the growth of net income for future years will be continued improvement in net interest and noninterest income. Our goal is to generate earnings sufficient to fund operations, adequately capitalize the Association, and achieve an adequate rate of return for our members. To meet this goal, the agricultural economy must continue the improvement shown in recent years and the Association must meet certain objectives. These objectives are to attract and maintain high quality loan volume priced at competitive rates and to manage credit risk in our entire portfolio, while efficiently meeting the credit needs of our members.

LIQUIDITY AND FUNDING SOURCES

Liquidity

Liquidity management is the process whereby funds are made available to meet all financial commitments including the extension of credit, payment of operating expenses and payment of debt obligations. The Association receives access to funds through its borrowing relationship with AgFirst Farm Credit Bank (the Bank) and from income generated by operations. The Association's participation in the Farmer Mac and other secondary market programs provides additional liquidity. Sufficient liquid funds have been available to meet all financial obligations.

Funding Sources

The principal source of funds for the Association is the borrowing relationship established with 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 Bank advances the funds to the Association, creating notes payable to the Bank. The notes payable are segmented into variable rate and fixed rate components. 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 December 31, 2004, were $157,765 as compared to $137,721 at December 31, 2003. The increase of 14.55 percent during the period is attributable to the increase in loan volume.

The Association had no lines of credit outstanding with third parties as of December 31, 2004.

Funds Management

The Bank and the Association manage assets and liabilities to provide a broad range of loan products and funding options, which will permit the Association to be competitive in all interest rate environments. The primary objective of the asset/liability management process is to provide stable and rising earnings, while maintaining adequate capital levels by managing exposure to credit and interest rate risks.

The majority of the interest rate risk in the Association balance sheet is transferred to the Bank through the notes payable structure. The Bank, in turn, actively utilizes funds management techniques to identify, quantify and control risk associated with the loan portfolio.

Demand for loan types is a driving force in establishing a funds management strategy. The Association offers fixed, adjustable and variable rate loan products that are marginally priced according to financial market rates. Variable rate loans may be indexed to either the Prime Rate or the 90-day London Interbank Offered Rate (LIBOR). Adjustable rate mortgages are indexed to U.S. Treasury Rates. Fixed rate loans are priced based on the current cost of Farm Credit debt of similar terms to maturity.

CAPITAL RESOURCES

Total members' equity at December 31, 2004, increased 24.86 percent to $21,197 from the December 31, 2003, total of $16,976. The increase was primarily attributed to net income (and the effect of the reversal of the allowance for loan losses) partially offset by cash patronage and the revolvement of allocated earnings.

Total capital stock and participation certificates were $3,924 on December 31, 2004, compared to $3,872 on December 31, 2003. This 1.34 percent increase is attributed to the excess of stock purchases above the normal retirement of stock on loans liquidated in the normal course of business.

The Association's capital ratios as of December 31 and the FCA minimum requirements follow:

	2004	2003	Regulatory Minimum
Permanent Capital	12.49%	12.58%	7.00%
Total Surplus	9.68%	9.69%	7.00%
Core Surplus	8.39%	8.23%	3.50%

At December 31, 2004, the Association's permanent capital ratio, average at-risk capital divided by average risk adjusted assets calculated in accordance with FCA regulations, exceeded the regulatory minimum of 7.00 percent. In addition to these regulatory requirements, the Association has established a permanent capital goal range in excess of the 7.00 percent FCA minimum requirement. As of December 31, 2004, the Association has met the goal range.

PATRONAGE PROGRAM

Prior to the beginning of any fiscal year, the Association's Board of Directors, by adoption of a resolution, may obligate the Association to distribute to borrowers on a patronage basis all or any portion of available consolidated net earnings of the Association and its subsidiaries for such fiscal year or for that and subsequent fiscal years. Refer to Note 8 of the Notes to the Consolidated Financial Statements for more information concerning the patronage distributions. The Association declared patronage distributions of $726 in 2004, $990 in 2003.

YOUNG, BEGINNING, AND SMALL FARMERS AND RANCHERS PROGRAM

The Association's mission statement includes providing sound and constructive credit and related services to young, beginning and small (YBS) farmers and ranchers. Annual marketing goals are established to increase market share of loans to YBS farmers and ranchers. Also, we are actively involved in developing and sponsoring educational opportunities, leadership training, business financial training and insurance services for YBS farmers and ranchers.

YBS farmers and ranchers are defined as:

Young Farmer: A farmer, rancher, or producer or harvester of aquatic products who is age 35 or younger as of the date the loan is originally made.

Beginning Farmer: A farmer, rancher, or producer or harvester of aquatic products who has 10 years or less farming or ranching experience as of the date loan is originally made.

Small Farmer: A farmer, rancher, or producer or harvester of aquatic products who normally generates less than $250 in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

The Association will strive to serve deserving members of this group by weighing the strong points of an applicant's financial position against the potential risk to the Association. Loan losses that occur because of circumstances beyond a borrower's control should not deter the Association from considering credit for this group. Risk should be minimized whenever possible, but it is recognized that risk cannot be avoided altogether. Loan officers are expected to review the criteria of each loan and assess that risk.

The Association promotes adequate credit availability to qualifying YBS applicants to ensure they receive all due consideration. The applicants that meet the definitions of this special group will be handled as any other applicant, except that loan staff is encouraged to look beyond the primary applicant toward other forms of strengthening the package, if warranted. Loan staff will ensure the loan is properly coded according to district procedures to monitor the level of effort expended on behalf of this group of borrowers.

While credit standards apply the same to all classes of borrowers, special emphasis is given to promote YBS financing through programs including, but not limited to, FSA or other governmental guarantees; interest rate buy-down programs offered by governmental guarantee programs; use of cosigner, joint applicant, or pledged collateral from other individuals to reduce risk to the Association; consideration of loan terms that may assist in cash flow development.

Additionally, the Association encourages the responsible transition of farm ownership to younger generations by providing access to estate and financial planners through an alliance partner (currently American Express Financial Advisors), use of credit terms that would assist in such a transition, and promotion of other available resources for farm transition assistance, such as the Cooperative Extension Management Specialists.

The Association currently has a very respectable penetration in the young, beginning, and small farmer market. As of December 31, 2004, the Association was doing business with 222 young farmer households yet only 183 young farmers were identified in the 2002 United State Department of Agriculture (USDA) Agriculture (Ag) census for the Association's eight counties served. Concerning beginning farmers, the Association has loans with 535 beginning farmer households verses 1221 farmers reporting in the 2002 USDA census as being on the farm less than 10 years. This translates to 44% beginning farmer penetration for the Association. The Association has loans with 969 small farmer households versus 4,146 small farmers reported in the 2002 USDA Ag Census, or 23% small farmer penetration.

The following table outlines the loan volume and number of YBS loans in the loan portfolio as of December 31 for the Association.

	December 31, 2004	
	Number of Loans	**Amount of Loans**
Young	301	$ 15,653
Beginning	768	65,032
Small	1,617	119,572

For purposes of the above table, a loan could be classified in more than one category depending upon the characteristics of the underlying borrower.

The Association had goals of $15,000, $55,000 and $95,000 for YBS loan volume in 2004. As illustrated by the above table, all three goals were exceeded.

The following strategies and outreach programs have been conducted which allowed the Association to meet its objectives and goals to date of the young, beginning, and small farmer program. Continued work and enhancement of these strategies and programs are on-going as the Association strives to increase its YBS market penetration.

- Promotion of "Youth in Agriculture" initiative includes supporting student and youth projects with the intent to educate today's youth about various career options and opportunities in agriculture. This includes, but is not limited to, numerous donations and sponsorships of 4-H, Future Farmers of America (FFA), and young farmer organizations' activities. Additionally, Association staff is encouraged to volunteer time to assisting with youth activities.
- Promotion of further education of current YBS customers (or potential customers) through hosting, sponsoring, or presenting agriculturally related workshops, seminars, and interactive meetings. Such meetings may range in topic from farm transition to operational issues such as beef management, crop insurance, or hay and pasture management.
- Development and implementation of numerous programs designed to assist the YBS segment, such as the Financially Related Services program, which is used to enhance the ability of YBS farms to obtain affordable services including various levels of life insurance and crop insurance. The Association offers appraisal services at competitive rates to assist in estate planning, farm transition, and leasing options to assist with alternatives to direct loan financing.

FORWARD LOOKING INFORMATION

Certain information included in this discussion constitutes forward-looking statements and information that are based upon management's belief as well as certain assumptions made by and information currently available to management. When used in this discussion, the words "anticipate," "project," "expect," "believe," and similar expressions are intended to identify forward-looking statements. Although management of the Association believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations and projections will prove to have been correct. Such forward-looking statements are subject to certain risks, uncertainties and assumptions. Should one or more of these risks materialize, or should such underlying assumptions prove to be incorrect, actual results may vary materially from those anticipated, projected, or expected. Among key factors that may have a direct bearing on the Association's operating results are fluctuations in the economy, the relative strengths and weaknesses in the agricultural credit sectors and in the real estate market, the actions taken by the Federal Reserve for the purpose of managing the economy, and the continued growth of the agricultural market consistent with recent historical experience.

Disclosure Required by Farm Credit Administration Regulations

Description of Business

Descriptions of the territory served, persons eligible to borrow, types of lending activities engaged in, financial services offered and related Farm Credit organizations are incorporated herein by reference to Note 1 to the consolidated financial statements, "Organization and Operations," included in this annual report to stockholders.

The description of significant developments that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting the business, seasonal characteristics, and concentrations of assets, if any, is incorporated in "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in this annual report to stockholders.

Description of Property

The following table sets forth certain information regarding the properties of the reporting entity, all of which are located in Virginia or West Virginia:

Location	Description	Form of Ownership
125 Prosperity Drive Winchester, VA	(2) Administrative/Branch 15,500 square feet	Owned
Prosperity Drive Winchester, VA	(3) Unimproved one acre lot – number 15 Kernstown Business Park	Owned
1288 Winchester Avenue Martinsburg, WV	Branch 2,060 square feet	Owned
1270 Winchester Avenue Martinsburg, WV	(1) Rental 2,062 square feet	Owned
1031 S. Main Street Woodstock, VA	Branch 3,456 square feet	Owned
South Main Street Woodstock, VA	(4) Unimproved one acre lot – number 2 Shenandoah Square.	Owned
108 North George Street Charles Town, WV	(5) Satellite Office Approx. 300 square feet	Leased
1258 Winchester Avenue Martinsburg, WV	(6) Lot With House Approx. 1,000 square feet	Owned
Ridgefield Business Park Martinsburg, WV	(7) Unimproved lots (numbers 2, 3 and 6) Approx. one and a half acres	Owned
14 Thomas Lane Berkeley Springs, WV	(8) Satellite Office Approx. 200 square feet	Leased
114 East Liberty Street Charles Town, WV	(9) Satellite Office Approx. 1,000 square feet	Leased

(1) This property was the previous location of the Association's Martinsburg, WV branch office. In previous years, the property had been rented to a commercial business. During 1998 and 2001, the property received extensive renovations.

The property is now rented to an American Express Financial Advisor. The Association has established a financial planning alliance with American Express to provide financial planning services to stockholders. Annual lease agreement effective January 1, 2005 – December 31, 2005. Changes in the lease agreement may be negotiated annually and effective on January 1st of each year.

The Association has leased back three offices totaling approximately 450 square feet. Annual lease effective January 1, 2005 – December 31, 2005.

(2) Approximately 2,500 square feet of space (representing two office suites) are rented to Association Alliances. Alliances are A New Century Realty and Farm Bureau. Alliances were formed to create opportunities for the Association membership to have real estate and insurance services available within one building.

The New Century Realty lease is for a period of five years commencing on March 1, 2001 (adjusted from an original date of March 16, 2000) and ending on April 30, 2005. The Association has leased back two offices totaling approximately 264 square feet, month to month lease effective June 1, 2004.

The Farm Bureau lease is for a period of five years commencing on April 1, 2000 and ending on March 31, 2005.

(3) Adjoining lot to the present Administrative/Branch Office Building.

(4) Adjoining lot to the present Branch Office Building.

(5) The Association has leased office space to enhance the Secondary Mortgage Market presence. Annual lease effective beginning on the 15th day of December, 2003 and on the 15th day of each month thereafter, through December 15,2004. The satellite office will be relocated as referenced in note number nine.

(6) Adjoins the present branch office properties.

(7) Relocation site of the Martinsburg branch office.

(8) The Association has leased office space to enhance the Secondary Mortgage Market presence. Annual lease effective September 1, 2004 through August 31, 2005.

(9) Relocation site of the Charles Town satellite office. Final lease details are pending completion of remodeling in January 2005.

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 13 to the consolidated financial statements, "Commitments and Contingencies," included in this annual report to stockholders.

Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 8 to the consolidated financial statements, "Members' Equity," included in this annual report to stockholders.

Description of Liabilities

The description of liabilities, contingent liabilities and intrasystem financial assistance rights and obligations to be disclosed in this section is incorporated herein by reference to Notes 2, 7, 11 and 13 to the consolidated financial statements included in this annual report to stockholders.

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

"Management's Discussion and Analysis of Financial Condition and Results of Operations," which appears in this annual report to stockholders and is to be disclosed in this section, is incorporated herein by reference.

Senior Officers

The following represents certain information regarding the senior officers of the Association:

Senior Officer	Position
Robert N. Carpenter	President and Chief Executive Officer
Luther O. Stiles	Executive Vice President and Chief Administrative Officer
Scott K. Swaim	Senior Vice President – Credit
Allan K. George	Senior Vice President – Lending Programs
Jeffrey B. Michael	Senior Vice President – Residential Lending
Stephen T. Grant	Vice President – Member Services
Mary S. Miller	Vice President – Chief Financial Officer
Ruth C.M. Boden	Vice President – Branch Manager
Cheryl G. Keesecker	Vice President – Branch Manager

The business experience for the past five years for senior officers is with the Farm Credit System with the exception of Mary S. Miller, who has been employed with Farm Credit approximately two and a half years. Mary S. Miller is a Certified Public Accountant and her prior business experience was with a manufacturing company and an international not-for-profit health organization.

The total amount of compensation earned by all senior officers as a group during the past three years will be included in the Association's 2005 Annual Meeting Information Statement.

Directors

Directors and senior officers are reimbursed on an actual cost basis for all expenses incurred in the performance of official duties. Such expenses may include transportation, lodging, meals, tips, tolls, parking of cars, laundry, registration fees, and other expenses associated with travel on official business. A copy of the policy is available to shareholders of the Association upon request.

The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was $41,125 for 2004, $30,197 for 2003 and $23,444 for 2002.

Subject to approval by the Board, the Association may allow directors honorarium for attendance at meetings, committee meetings, or special assignments. The following table outlines 2004 honorariums:

Description	Honorarium
Board Retainer	$1,500/annually
Board meetings, official board functions	$300/day
Board committees	$200/day
Board meetings via conference call	$75/day

Total compensation paid to directors as a group totaled $49,300. A majority of the Board attended a Farm Credit Council Conference for three days in 2004. The honorarium was waived.

The following represents certain information regarding the directors of the Association and their business experience for the past five years:

Charles W. Kackley, Chairman, is a beef cattle, small grain farmer and owner of a small mowing business. Mr. Kackley serves on the Boards of the Clarke County Zoning Appeals (Chairman), Clarke County Fair (Vice Chairman), and Clarke County Education Foundation, Berryville, Virginia. Mr. Kackley is a member of the Clarke County Ruritan Club, Clarke County Chamber of Commerce, and Berryville Baptist Church (past deacon), Berryville, Virginia. During 2004, he served eight days at Association board meetings and twelve days in other official activities and was paid $7,375. His term of office is 2002 – 2005.

John P. Burns, Jr., Vice Chairman, is a beef cattle and grain farmer. He is a director on the Boards of the Bank of Charles Town, Charles Town, West Virginia and Jefferson County Fair (Director 42 years; President 39 years), Jefferson County, West Virginia. Mr. Burns is also a member of the Jefferson County Farm Bureau, Jefferson County, West Virginia and past elder and deacon (20 years) in the Charles Town Presbyterian Church, Charles Town, West Virginia. During 2004, he served eight days at Association board meetings and fifteen days in other official activities and was paid $7,375. His term of office is 2003 – 2006.

Gary W. Bushong is a 250 herd dairy farmer. He is a member of the Rockingham Cooperative Farm Bureau (past director), Harrisonburg, Virginia; Broadway-Timberville Young Farmers, Broadway, Virginia; Raders Lutheran Church, Timberville, Virginia and National Young Farmers Association. During 2004, he served eight days at Association board meetings and nine days in other official activities and was paid $5,575. His term of office is 2004 – 2007.

T. Jeffery Jennings is a beef and poultry farmer. He is a director on the Board of the Culpeper Farmers' Cooperative, Culpeper, Virginia. Mr. Jennings is active in the Luray United Methodist Mens Group and Mission Teams. During 2003, Mr. Jennings was the recipient of the Pilgrim's Pride Environmental Excellence Award for Virginia for superior commitment to environmental practices. In 2004, Mr. Jennings was one of five winners of the Virginia Poultry Federation's Environmental Stewardship Award. During 2004, he served eight days at Association board meetings and eight days in other official activities and was paid $5,675. His term of office is 2004 – 2007.

Harry M. (Marty) Kable is a crop farmer, auctioneer and land developer. He is a director on the Boards of the Jefferson County Public Service District (Chairman), Jefferson County, West Virginia and Harpers Ferry Cooking Club, (Past President), Harpers Ferry, West Virginia. Mr. Kable is a member of the Jefferson County Farm Bureau (Past President), Jefferson County, West Virginia; the Presbyterian Church, Charles Town, West Virginia and Creek Hill Hunting Club (President), Baker, West Virginia. Mr. Kable is also Vice President of Sunrise Shale, Incorporated, Jefferson County, West Virginia. During 2004, he served seven days at Association Board Meetings and thirteen days in other official activities and was paid $6,475. His term of office is 2002 – 2005.

Jim A. Long is a beef and poultry farmer. He is a director on the Board of the Shenandoah Memorial Hospital (Vice Chairman), Woodstock, Virginia. During 2004, he served seven days at Association board meetings and nine days in other official activities and was paid $5,275. His term of office is 2003 – 2006.

Charles W. Orndoff, Sr. is a beef cattle farmer. He is a director on the Boards of the Farmer's Livestock Exchange, Incorporated, Winchester, Virginia and the Clearbrook Volunteer Fire Company, Clearbrook, Virginia. Mr. Orndoff is also a member of the Frederick County Farm Bureau, Stonewall Ruritan Club and White Hall Methodist Church, Frederick County, Virginia. During 2004, he served eight days at Association board meetings and thirteen days in other official activities and was paid $6,375. His term of office is 2003 – 2006.

Betty H. Carroll, Outside Director, is a retired commercial banker. She is a former Chief Executive Officer, President and Vice-Chairman of the commercial bank's Board of Directors. She is currently a director on the Advisory Board for the Blue Ridge Region of Branch Banking and Trust Company and the Handley High School Museum and Archive of Winchester, Winchester, Virginia. She is a member of the Board of Trustees, Shenandoah University (serves as their Secretary; member of the Executive Committee and Endowment Committee of the University) and a member of the Winchester Medical Center's Advisory Group, Winchester, Virginia. She has served on the boards of the Winchester-Frederick County Chamber of Commerce, Salvation Army, Shalom et Benedictus (a drug rehabilitation center) and The Free Medical Clinic, Winchester, Virginia. She also served on the Board of the Virginia Bankers Association, Richmond, Virginia and is past chairman of the Group III, Virginia Bankers Association. She is a former member of the Financial Bank Women International – Virginia Valley Group. Mrs. Carroll was appointed to serve on the Center for Rural Development by the Governor of Virginia. During 2004, she served six days at Association board meetings and six days in other official activities and was paid $5,175. Her term of office is 2003 – 2006.

Transactions with Senior Officers and Directors

The reporting entity's policies on loans to and transactions with its officers and directors, to be disclosed in this section are incorporated herein by reference to Note 12 to the consolidated financial statements, "Related Party Transactions," included in this annual report to stockholders.

Involvement in Certain Legal Proceedings

There were no matters which came to the attention of management or the board of directors regarding involvement of current directors or senior officers in specified legal proceedings which should be disclosed in this section.

Relationship with Independent Public Accountants

There were no material disagreements with our independent public accountants on any matter of accounting principles or financial statement disclosure during this period.

Consolidated Financial Statements

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated March 2, 2005, and the report of management, which appear in this annual report to stockholders are incorporated herein by reference.

Copies of the Association's quarterly reports are 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. Information concerning Valley Farm Credit, ACA can also be obtained by going to the Association's website at *www.valleyfc.com*.

Borrower Information Regulations

Since 1972, Farm Credit Administration (FCA) regulations have required that borrower information be held in strict confidence by Farm Credit System (FCS) institutions, their directors, officers and employees. These regulations provide Farm Credit institutions clear guidelines for protecting their borrowers' nonpublic personal information.

On November 10, 1999, the FCA Board adopted a policy that requires FCS institutions to formally inform new borrowers at loan closing of the FCA regulations on releasing borrower information and to address this information in the annual report to shareholders. The implementation of these measures ensures that new and existing borrowers are aware of the privacy protections afforded them through FCA regulations and Farm Credit System institution efforts.

Stockholder Investment

Stockholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of the District annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378 or writing Jay Wise, AgFirst Farm Credit Bank, P. O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained by going to AgFirst's website at *www.agfirst.com*.

Audit Committee Report

The Audit Committee of the Board of Directors (the Committee) is comprised of the directors named below. None of the directors who serve on the Audit Committee is an employee of Valley Farm Credit, ACA (the Association) and in the opinion of the Board of Directors, each is free of any relationship with the Association or management that would interfere with the director's independent judgment on the Committee.

The Committee has adopted a written charter that has been approved by the Board of Directors. The Committee has reviewed and discussed the Association's audited financial statements with management, which has primary responsibility for the financial statements.

PricewaterhouseCoopers LLP (PwC), the Association's independent auditor for 2004, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with generally accepted accounting principles. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 61 *(Communication With Audit Committees)*. PwC has provided to the Committee the written disclosures and the letter required by Independence Standards Board Standard No. 1 *(Independence Discussions with Audit Committees)*, and the Committee has discussed with PwC that firm's independence.

The Committee has also concluded that PwC's provision of non-audit services, if any, to the Association is compatible with PwC's independence.

Based on the considerations referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in the Association's Annual Report for 2004 and that PwC be appointed independent auditor for the Association for 2005. The foregoing report is provided by the following independent directors, who constitute the Audit Committee:

John P. Burns, Jr.
Chairman of the Audit Committee

Members of Audit Committee

Betty H. Carroll
Charles W. Kackley
Charles W. Orndoff, Sr.

Report of Independent Auditors

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
10 Tenth Street, Suite 1400
Atlanta, GA 30309
Telephone (678) 419 1000

Report of Independent Auditors

March 2, 2005

To the Board of Directors and Stockholders
of Valley Farm Credit, ACA

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of changes in members' equity and of cash flows present fairly, in all material respects, the financial position of Valley Farm Credit, ACA and its subsidiaries at December 31, 2004, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

Consolidated Balance Sheets

(dollars in thousands)	December 31, 2004	December 31, 2003	December 31, 2002
Assets			
Cash	$ 381	$ 706	$ 211
Loans	171,768	153,411	137,434
Less: allowance for loan losses	828	2,826	2,773
Net loans	170,940	150,585	134,661
Accrued interest receivable	879	935	878
Investment in AgFirst Farm Credit Bank	2,061	1,393	1,393
Premises and equipment, net	3,908	3,458	3,510
Other assets	4,088	1,246	1,411
Total assets	$ 182,257	$ 158,323	$ 142,064
Liabilities			
Notes payable to AgFirst Farm Credit Bank	$ 157,765	$ 137,721	$ 122,606
Accrued interest payable	546	466	520
Patronage refund payable	229	334	274
Minimum pension liability	—	1,104	1,176
Other liabilities	2,520	1,722	1,376
Total liabilities	161,060	141,347	125,952
Commitments and contingencies			
Members' Equity			
Capital stock and participation certificates	3,924	3,872	3,896
Retained earnings			
Allocated	4,388	4,360	4,343
Unallocated	12,885	10,066	9,400
Accumulated other comprehensive income (loss)	—	(1,322)	(1,527)
Total members' equity	21,197	16,976	16,112
Total liabilities and members' equity	$ 182,257	$ 158,323	$ 142,064

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

Consolidated Statements of Income

(dollars in thousands)	For the year ended December 31, 2004	2003	2002
Interest Income			
Loans	$ 9,450	$ 8,803	$ 9,148
Interest Expense			
Notes payable to AgFirst Farm Credit Bank	5,933	5,684	6,487
Net interest income	3,517	3,119	2,661
Provision for (reversal of) loan losses	(2,000)	50	229
Net interest income after provision for (reversal of) loan losses	5,517	3,069	2,432
Noninterest Income			
Loan fees	258	626	518
Fees for financially related services	109	97	90
Patronage refund from AgFirst Farm Credit Bank	1,609	1,042	947
Gain (loss) on sale of rural home loans	791	1,299	981
Other noninterest income	86	89	81
Total noninterest income	2,853	3,153	2,617
Noninterest Expense			
Salaries and employee benefits	2,958	2,908	2,096
Occupancy and equipment	505	493	466
Insurance Fund premium	74	153	36
Other operating expenses	1,227	982	903
Total noninterest expense	4,764	4,536	3,501
Income before income taxes	3,606	1,686	1,548
Provision (benefit) for income taxes	(1)	104	(120)
Net income	$ 3,607	$ 1,582	$ 1,668

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

Consolidated Statements of Changes in Members' Equity

(dollars in thousands)	Capital Stock and Participation Certificates	Retained Earnings Allocated	Retained Earnings Unallocated	Accumulated Other Comprehensive Income	Total Members' Equity
Balance at December 31, 2001	$ 3,939	$ 4,355	$ 8,631	$ —	$ 16,925
Comprehensive income					
Net income			1,668		1,668
Minimum pension liability adjustment				(1,527)	(1,527)
Total comprehensive income					141
Capital stock/participation certificates issued	316				316
Capital stock/participation certificates retired	(359)				(359)
Patronage distribution					
Cash			(270)		(270)
Nonqualified allocated retained earnings		630	(630)		—
Retained earnings retired		(651)			(651)
Distribution adjustment		9	1		10
Balance at December 31, 2002	3,896	4,343	9,400	(1,527)	16,112
Comprehensive income					
Net income			1,582		1,582
Minimum pension liability adjustment				205	205
Total comprehensive income					1,787
Capital stock/participation certificates issued	231				231
Capital stock/participation certificates retired	(255)				(255)
Patronage distribution					
Cash			(326)		(326)
Nonqualified allocated retained earnings		664	(664)		—
Retained earnings retired		(574)			(574)
Distribution adjustment		(73)	74		1
Balance at December 31, 2003	3,872	4,360	10,066	(1,322)	16,976
Comprehensive income					
Net income			3,607		3,607
Minimum pension liability adjustment				1,322	1,322
Total comprehensive income					4,929
Capital stock/participation certificates issued	316				316
Capital stock/participation certificates retired	(264)				(264)
Patronage distribution					
Cash			(218)		(218)
Nonqualified allocated retained earnings		508	(508)		—
Retained earnings retired		(561)			(561)
Distribution adjustment		81	(62)		19
Balance at December 31, 2004	$ 3,924	$ 4,388	$ 12,885	$ —	$ 21,197

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

Consolidated Statements of Cash Flows

(dollars in thousands)	For the year ended December 31, 2004	2003	2002
Cash flows from operating activities:			
Net income	$ 3,607	$ 1,582	$ 1,668
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation on premises and equipment	323	317	285
Provision for (reversal of) loan losses	(2,000)	50	229
(Gains) losses on rural home loans	(791)	(1,299)	(981)
Originations of rural home loans held for sale	(54,284)	(89,807)	(71,915)
Proceeds from sale of rural home loans held for sale	55,075	91,106	72,896
Changes in operating assets and liabilities:			
(Increase) decrease in accrued interest receivable	56	(57)	20
(Increase) decrease in other assets	(1,520)	165	(445)
Increase (decrease) in accrued interest payable	80	(54)	(24)
Increase (decrease) in minimum pension liability	(1,104)	(72)	1,176
Increase (decrease) in other liabilities	798	551	(1,323)
Total adjustments	(3,367)	900	(82)
Net cash provided by (used in) operating activities	240	2,482	1,586
Cash flows from investing activities:			
Net (increase) decrease in loans	(18,355)	(15,974)	(11,362)
(Increase) decrease in investment in AgFirst Farm Credit Bank	(668)	—	—
Purchase of premises and equipment, net	(773)	(265)	(374)
Net cash provided by (used in) investing activities	(19,796)	(16,239)	(11,736)
Cash flows from financing activities:			
Advances on (repayment of) notes payable to AgFirst Farm Credit Bank, net	20,044	15,115	10,582
Capital stock and participation certificates issued	316	231	316
Capital stock and participation certificates retired	(264)	(255)	(359)
Patronage refunds paid	(304)	(265)	(139)
Retained earnings retired	(561)	(574)	(651)
Net cash provided by (used in) financing activities	19,231	14,252	9,749
Net increase (decrease) in cash	(325)	495	(401)
Cash, beginning of period	706	211	612
Cash, end of period	$ 381	$ 706	$ 211
Supplemental schedule of non-cash activities:			
Cash dividends or patronage distributions declared or payable	$ 218	$ 326	$ 270
Decrease (increase) in accumulated other comprehensive income related to minimum pension liability	1,322	205	(1,527)
Supplemental information:			
Interest paid	$ 5,853	$ 5,738	$ 6,511
Taxes paid, net	—	—	—
Federal tax refunds related to long-term operations (Note 9)	—	4	120

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

Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

Note 1 — Organization and Operations

A. **Organization:** Valley Farm Credit, ACA (the Association) is a member-owned cooperative which provides credit and credit-related services to or for the benefit of eligible borrowers/stockholders for qualified purposes in the counties of Clarke, Frederick, Warren, Shenandoah and Page in the state of Virginia, and Berkeley, Morgan and Jefferson in the state of West Virginia.

The Association is a lending institution of the Farm Credit System (the System), a nationwide system of cooperatively owned Banks and Associations, which was established by Acts of Congress to meet the credit needs of American agriculture and is subject to the provisions of the Farm Credit Act of 1971, as amended (the Farm Credit Act). The most recent significant amendment to the Farm Credit Act was the Agricultural Credit Act of 1987. At December 31, 2004, the System was comprised of four Farm Credit Banks and one Agricultural Credit Bank and numerous Associations.

AgFirst Farm Credit Bank (Bank) and its related Associations are collectively referred to as the "District." The Bank provides funding to all associations within the District and is responsible for supervising certain activities of the District Associations, as well as the other associations operating within the AgFirst District. The District consists of the Bank and twenty-three ACAs, twenty-one of which have reorganized as Agricultural Credit Association (ACA) parent-companies, which have two wholly owned subsidiaries, a Federal Land Credit Association (FLCA) and a Production Credit Association (PCA). Effective January 1, 2005, the two remaining Associations have reorganized as ACA holding companies.

ACA parent-companies provide financing and related services through its FLCA and PCA subsidiaries. The FLCA makes secured long-term agricultural real estate and rural home mortgage loans. The PCA makes short-and intermediate-term loans for agricultural production or operating purposes.

The Farm Credit Administration (FCA) is delegated authority by Congress to regulate the System banks and associations. The activities of the associations are examined by the FCA and certain actions by the associations are subject to the prior approval of the FCA and the supervising Bank.

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Fund is required to be used (1) to ensure the timely payment of principal and interest on Systemwide debt obligations (Insured debt), (2) to ensure the retirement of protected borrower capital at par or stated value, and (3) for other specified purposes. The Insurance Fund is also available for discretionary uses by the Insurance Corporation of providing assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank is required to pay premiums into the Insurance Fund, based on its annual average loan principal outstanding until the monies in the Insurance Fund reach the "secure base amount," which is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (Systemwide debt obligations). When the amount in the Insurance Fund exceeds the secure base amount, the Insurance Corporation is required to reduce premiums, but it still must ensure that reduced premiums are sufficient to maintain the level of the Insurance Fund at the secure base amount.

B. **Operations:** The Farm Credit Act sets forth the types of authorized lending activity, persons eligible to borrow, and financial services which can be offered by the Association. The Association is authorized to provide, either directly or in participation with other lenders, credit, credit commitments and related services to eligible borrowers. Eligible borrowers include farmers, ranchers, producers or harvesters of aquatic products, rural residents, and farm-related businesses.

The Association may sell to any Farm Credit borrowing member, on an optional basis, credit or term life insurance appropriate to protect the loan commitment in the event of death of the debtor(s). The sale of other insurance necessary to protect a member's farm or aquatic unit is permitted, but limited to hail and multi-peril crop insurance, and insurance necessary to protect the facilities and equipment of aquatic borrowers.

Upon request, stockholders of the Association will be provided with an AgFirst Farm Credit Bank Annual Report to Stockholders, which includes the combined financial statements of the Bank and its related Associations. The Association's financial condition may be impacted by factors that affect the Bank. The AgFirst Annual Report discusses the material aspects of the District's financial condition, changes in financial condition, and results of operations. In addition, the AgFirst Annual Report identifies favorable and unfavorable trends, significant events, uncertainties and the impact of activities of the Financial Assistance Corporation Assistance Board (Assistance Board) and Insurance Corporation.

The lending and financial services offered by the Bank are described in Note 1 of the District's Annual Report to Stockholders.

Note 2 — Summary of Significant Accounting Policies

The accounting and reporting policies of the Association conform with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant estimates are discussed in these footnotes, as applicable. Actual results may differ from these estimates.

Certain amounts in prior years' financial statements have been reclassified to conform to current consolidated financial statement presentation. Such reclassifications had no effect on net income or total members' equity of prior years. The consolidated financial statements include the accounts of the FLCA and the PCA. All significant inter-company transactions have been eliminated in consolidation.

A. **Cash:** Cash, as included in the statement of cash flows, represents cash on hand and on deposit at banks.

B. **Loans and Allowance for Loan Losses:** Long-term real estate mortgage loans generally have maturities ranging up to 30 years. Substantially all short- and intermediate-term loans for agricultural production or operating purposes have maturities of 10 years or less.

Loans are carried at their principal amount outstanding less unearned income. Interest on loans is accrued and credited to interest income based upon the principal amount outstanding. Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days or more (unless adequately secured and in the process of collection) or circumstances indicate that collection of principal and/or interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is reversed (if accrued in the current year) or charged against the allowance for loan losses (if accrued in prior years).

When loans are in nonaccrual status, the interest portion of payments received in cash is generally recognized as interest income if collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it. Otherwise, loan payments are applied against the recorded investment in the loan asset. Nonaccrual loans may be transferred to accrual status when principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected and the loan is not classified "doubtful" or "loss."

In cases where a borrower experiences financial difficulties and the Association makes certain monetary concessions to the borrower through modifications to the contractual terms of the loan, the loan is classified as a restructured loan. If the borrower's ability to meet the revised payment schedule is uncertain, the loan is classified as a nonaccrual loan.

Loan origination fees and direct loan origination costs are deferred as part of the carrying amount of the loan and the net fee or cost is amortized over the life of the related loan as an adjustment to yield.

The allowance for loan losses is a valuation account used to reasonably estimate loan and lease losses existing as of the financial statement date. Determining the appropriate allowance for loan losses balance involves significant judgment about when a loss has been incurred and the amount of that loss. The determination of the allowance for loan losses is based on management's current judgments about the credit quality of its loan and lease portfolio. A specific allowance may be established for impaired loans under SFAS No. 114. Impairment of these loans is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as practically expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent. See Note 3 for a discussion on the refinement of the allowance for loan losses methodology.

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance is increased through provisions for loan losses and loan recoveries and is decreased through reversals of provisions for loan losses and loan charge-offs.

The allowance is based on a periodic evaluation of the loan portfolio by management in which numerous factors are considered, including economic conditions, loan portfolio composition and prior loan loss experience. It is based on estimates, appraisals and evaluations of loans which, by their nature, contain elements of uncertainty and imprecision. The possibility exists that changes in the economy and its impact on borrower repayment capacity will cause these estimates, appraisals and evaluations to change.

The level of allowance for loan losses is generally based on recent charge-off experience adjusted for relevant environmental factors. The Association considers the following factors when adjusting the historical charge-offs experience:

- Changes in credit risk classifications,
- Changes in collateral values,
- Changes in risk concentrations,
- Changes in weather related conditions, and
- Changes in economic conditions.

C. **Gains/(Losses) on Loans Held for Sale:** Certain rural home loans originated by the Association are sold on a servicing released basis primarily to the Bank or into the secondary market to unrelated third parties. For loans sold to the Bank, the Association locks into a selling price with the Bank at the time that the Association enters into a commitment to lend to the potential borrower. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold.

D. **Investment in AgFirst Farm Credit Bank:** The Association is required to maintain ownership in the Bank in the form of Class C stock. Accounting for this investment is on the cost plus allocated equities basis. Patronage refunds from the Bank are accrued as earned. The receivable for such patronage refunds is included in other assets.

E. **Other Property Owned:** Other property owned, consisting of real and personal property acquired through a collection action, is recorded at fair value less estimated selling costs upon acquisition. Revised estimates to the fair value less cost to sell are reported as adjustments to the carrying amount of the asset, provided that such adjusted value is not in excess of the carrying amount at acquisition. Income and expenses from operations and carrying value adjustments are included in gains (losses) on other property owned.

F. **Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated useful lives of the assets. Gains and losses on dispositions are reflected in current operations. Maintenance and repairs are charged to operating expense and improvements are capitalized.

G. **Advanced Conditional Payments:** The Association is authorized under the Farm Credit Act to accept advance payments from borrowers. To the extent the borrower's access to such advance payments is restricted, the advanced conditional payments are netted against the borrower's related loan balance. Amounts in excess of the related loan balance and amounts to which the borrower has unrestricted access are presented as interest-bearing liabilities in the accompanying Balance Sheet. Advanced conditional payments are not insured. Interest is generally paid by the Association on such accounts.

H. **Employee Benefit Plans:** The employees of the Association participate in the Retirement Plan (the Plan) of the AgFirst District, which is a defined benefit plan. The District utilizes the "Projected Unit Credit" actuarial method for financial reporting purposes and for funding purposes. As a result of the funded status at the Plan's measurement date (September 30) of the underlying Plan, the Association may record a minimum liability, an intangible asset relating to unrecognized prior service cost and other comprehensive income (loss). The adjustment to other comprehensive income (loss) would be net of deferred taxes, if significant. For participants hired before January 1, 2003, benefits are determined based on a final average pay formula. For those participants hired on or after January 1, 2003, benefits are determined using a cash balance formula.

   The employees of the Association are eligible to participate in the District's thrift plan (Thrift Plan), which qualifies as a 401(k) plan as defined by the Internal Revenue Code. The Association will contribute $1.00 for each $1.00 of the maximum employee contribution of 6 percent of total compensation. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. Thrift Plan costs are expenses as funded.

   The Association provides certain health care and life insurance benefits to eligible retired employees. Substantially all employees may become eligible for these benefits if they reach early retirement age while working for the Association. Expenses of $187, $189 and $128 for the years ended December 31, 2004, 2003 and 2002, respectively, were classified as salaries and employee benefits.

I. **Income Taxes:** The Association is generally subject to Federal and certain other income taxes. The Association is eligible to operate as a cooperative that qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, under specified conditions, the Association can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus. Provisions for income taxes are made only on those taxable earnings that will not be distributed as qualified patronage refunds. The Association distributes patronage on the basis of book income. The Association recognizes deferred tax assets and liabilities for the expected future tax consequences of the temporary differences between the carrying amounts and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled. Valuation allowance is provided at the balance sheet dates against that portion of the Association's deferred tax assets that it is more likely than not (50 percent probability), based on management's best estimates of future events and circumstances, that will not be realized.

J. **Patronage Refund from AgFirst:** The Association records patronage refunds from the Bank on an accrual basis.

Note 3 – Refinement of the Allowance for Loan Losses Methodology

During 2004, the Association conducted a study to further refine its allowance for loan losses methodology taking into account recently issued guidance by FCA, the System's regulator, as well as the Securities and Exchange Commission (SEC) and Federal Financial Institutions Examination Council guidelines.

The Association's allowance for loan losses methodology was adjusted and revised in the late 1980s to take into account credit losses in that period. Given the long cyclical nature of the agricultural economy, loss factors utilized to determine the allowance for loan losses subsequent to 1989 continued to reflect, to some extent, the loss history of the mid-to-late 1980s, which resulted in conservative estimates of the allowance for loan losses. The Association's allowance for loan losses methodology utilized throughout the period was in accordance with generally accepted accounting principles and was consistently applied.

While conservative in estimating the allowance for loan losses, the methodology used resulted in annual provisions for loan losses over the periods that reflected changes in credit quality and loss experience. Accordingly, the reserves provided in the mid-to-late 1980s have, in effect, remained part of the allowance for loan losses. The Association's allowance for loan losses methodology has consistently adhered to proper accounting policies, under the regulatory supervision of FCA in its role as a "safety and soundness" regulator. It was FCA's view that the allowance for loan losses should include among others, an assessment of: probable losses, historical loss experience and economic conditions.

In April 2004, FCA issued an "Informational Memorandum" to System institutions regarding the criteria and methodologies that would be used in evaluating the adequacy of a System institution's allowance for loan losses. FCA endorsed the direction provided by other bank regulators and the SEC and indicated the conceptual framework addressed in their guidance would be included as part of their examination process.

During the fourth quarter of 2004, the Association completed its study and refined its methodology to be in compliance with the guidance discussed in the previous paragraph. The refinement in methodology resulted in a calculated allowance for loan losses that was significantly less than the previously recorded balance due to revised loss factors that are more indicative of actual loss experience in recent years and current borrower analysis.

While the $2,000 reversal had a significant impact on 2004 results of operations and the previously recorded allowance for loan losses, the refinement in methodology is not expected to have a significant impact on comparative results of operations in future periods. Additionally, the refinement in methodology did not have a significant impact on the level of the risk bearing capacity of the Association, generally referred to as "risk funds" (capital plus the allowance for loan losses), which totaled $22,025 at December 31, 2004 (12.82 percent of Association loans), as compared with $19,802 at December 31, 2003 (12.91 percent of Association loans).

Note 4 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31, 2004	2003	2002
Long-term farm mortgage	$ 96,002	$ 84,213	$ 77,271
Production and intermediate-term	51,651	43,629	34,637
Rural home	19,447	19,885	20,973
Farm related business	3,766	3,661	3,771
Processing and marketing	938	1,088	1,238
Nonaccruals	—	—	17
Plus: participations purchased	1,336	3,602	2,393
Less: participations sold	(1,372)	(2,667)	(2,866)
Total	$ 171,768	$ 153,411	$ 137,434

The Association's concentration of credit risk in various agricultural commodities is shown in the following table. While the amounts represent the Association's maximum potential credit risk as it relates to recorded loan principal, a substantial portion of the Association's lending activities is collateralized and the Association's exposure to credit loss associated with lending activities is reduced accordingly. An estimate of the Association's credit risk exposure is considered in the determination of the allowance for loan losses.

Total loans at December 31, 2004, 2003 and 2002 consisted of the following commodity types:

Commodity Type	December 31, 2004	2003	2002
Part-time and Other	30%	27%	29%
Livestock	25	23	21
Poultry	21	23	26
Rural Home	10	12	14
Orchard	8	8	6
Dairy	6	7	4
Total	100%	100%	100%

The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but typically includes farmland and income-producing property, such as crops and livestock, as well as receivables. Long-term real estate loans are secured by the first liens on the underlying real property. Federal regulations state that long-term real estate loans are not to exceed 85 percent (97 percent if guaranteed by a government agency) of the property's appraised value. However, a decline in a property's market value subsequent to loan origination or advances, or other actions necessary to protect the financial interest of the Association in the collateral, may result in the loan to value ratios in excess of the regulatory maximum.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms.

The following table presents information relating to impaired loans.

	December 31, 2004	2003	2002
Nonaccrual loans:			
Current as to principal and interest	$ —	$ —	$ —
Past due	—	—	17
Total nonaccrual loans	—	—	17
Impaired accrual loans:			
Restructured accrual loans	—	—	—
Accrual loans 90 days or more past due	84	—	182
Total impaired accrual loans	84	—	182
Total impaired loans	$ 84	$ —	$ 199

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2004.

Interest income is recognized and cash payments are applied on nonaccrual impaired loans as described in Note 2. The following table presents interest income recognized on impaired loans.

	Year Ended December 31, 2004	2003	2002
Interest income recognized on nonaccrual loans	$ —	$ 5	$ 240
Interest income on impaired accrual loans	1	16	13
Interest income recognized on impaired loans	$ 1	$ 21	$ 253

The following table presents information concerning impaired loans as of December 31,

	2004	2003	2002
Impaired loans with related allowance	$ 4	$ —	$ 16
Impaired loans with no related allowance	80	—	183
Total impaired loans	$ 84	$ —	$ 199
Allowance on impaired loans	$ 4	$ —	$ 16

The following table summarizes impaired loan information for the year ended December 31,

	2004	2003	2002
Average impaired loans	$ 8	$ 166	$ 158

A summary of the changes in the allowance for loan losses follows:

	Year Ended December 31, 2004	2003	2002
Balance at beginning of year	$ 2,826	$ 2,773	$ 2,547
Provision for loan losses	—	50	229
Nonrecurring provision for loan losses reversal*	(2,000)	—	—
Loans charged off	—	—	(3)
Recoveries	2	3	0
Balance at end of year	$ 828	$ 2,826	$ 2,773

* *Represents the amount of provision reversal due to the change in methodology.*

	2004	2003	2002
Ratio of net charge-offs during the period to average loans outstanding during the period	(0.001)%	(0.001)%	0.002%

As previously discussed in Note 3, the nonrecurring provision for loan losses reversal resulted from the refinement of the Association's allowance for loan losses methodology.

To mitigate the risk of loan losses, the Association entered into long-term standby commitments to purchase agreements with the Federal Agricultural Mortgage Corporation (Farmer Mac) during 2004. The agreements, which are effectively credit guarantees that will remain in place until the loans are paid in full, give the Association the right to sell the loans identified in the agreements to Farmer Mac in the event of default, subject to certain conditions. The balance of loans under long-term standby commitments was $11,688 at December 31, 2004. Fees paid to Farmer Mac for such commitments totaled $17 for the year ended December 31, 2004. These amounts are classified as noninterest expense.

Note 5 — Investment in AgFirst Farm Credit Bank

The Association is required to maintain ownership in the Bank of Class C stock as determined by the Bank. The Bank may require additional capital contributions to maintain its capital requirements.

Note 6 — Premises and Equipment

Premises and equipment consisted of the following:

	December 31, 2004	2003	2002
Land	$ 842	$ 521	$ 521
Buildings and improvements	2,796	2,602	2,593
Furniture and equipment	1,603	1,444	1,425
	5,241	4,567	4,539
Less: accumulated depreciation	1,333	1,109	1,029
Total	$ 3,908	$ 3,458	$ 3,510

Note 7 — Notes Payable to AgFirst Farm Credit Bank

The Association's indebtedness to the Bank represents borrowings by the Association to fund its loan portfolio. This indebtedness is collateralized by a pledge of substantially all of the Association's assets and the terms of the revolving lines of credit are governed by a general financing agreement. Interest rates on both variable and fixed rate notes payable are generally established loan-by-loan based on the Bank's marginal cost of funds, capital position, operating costs and return objectives. The interest rate is periodically adjusted by the Bank based upon agreement between the Bank and Association. The weighted average interest rates on the variable rate notes were 3.39 percent for LIBOR-based loans, 3.17 percent for Prime-based loans, and the weighted average remaining maturities were 7.0 years and 2.0 years, respectively, at December 31, 2004. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) notes payable which are match funded by the Bank was 4.47 percent and the weighted average remaining maturity was 8.4 years at December 31, 2004. The weighted average interest rate on all interest-bearing notes payable was 4.11 percent and the weighted average remaining maturity was 7.2 years at December 31, 2004.

Variable rate and fixed rate notes payable represent approximately 22.10 percent and 77.90 percent, respectively, of total notes payable at December 31, 2004.

The Bank, consistent with FCA regulations, has established limitations on the Association's ability to borrow funds based on specified factors or formulas relating primarily to credit quality and financial condition. At December 31, 2004, the Association's notes payable were within the specified limitations.

Note 8 — Members' Equity

A description of the Association's capitalization requirements, protection mechanisms, regulatory capitalization requirements and restrictions, and equities are provided below.

A. Capital Stock and Participation Certificates

In accordance with the Farm Credit Act and the Association's capitalization bylaws, each borrower is required to invest in Class C stock for agricultural loans, or participation certificates in the case of rural home and farm related business loans, as a condition of borrowing. The statutory minimum investment is $1 thousand or two percent of the amount of the loan, whichever is less. At December 31, 2004, the Association had a borrower capitalization requirement of $2 thousand (except rural home loans which are $1,000), or two percent of the loan amount, whichever is less. The Board of Directors may increase the amount of investment if necessary to meet the Association's capital needs. The bylaws of the Association provide for a maximum not to exceed ten percent (10 percent) of the loan amount. Loans designated for sale or sold into the Secondary Market on or after February 10, 1996 will have no voting stock or participation certificate purchase requirement if sold within 180 days following the date of designation.

The borrower acquires ownership of the capital stock or participation certificates at the time the loan is made, but usually does not make a cash investment. The aggregate par value is generally added to the principal amount of the related loan obligation. The Association retains a first lien on the stock or participation certificates owned by borrowers. Retirement of such equities will generally be at the lower of par or book value, and repayment of a loan does not automatically result in retirement of the corresponding stock or participation certificates.

B. Regulatory Capitalization Requirements and Restrictions

FCA's capital adequacy regulations require the Association to achieve permanent capital of seven percent of risk-adjusted assets and off-balance-sheet commitments. Failure to meet the seven percent capital requirement can initiate certain mandatory and possibly additional discretionary actions by FCA that, if undertaken, could have a direct material effect on the Association's financial statements. The Association is prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless prescribed capital standards are met. FCA regulations also require that additional minimum standards for capital be achieved. These standards require all System institutions to achieve and maintain ratios as defined by FCA regulations. These required ratios are total surplus as a percentage of risk-adjusted assets of seven percent and of core surplus as a percentage of risk-adjusted assets of three and one-half percent. The Association's permanent capital, total surplus and core surplus ratios at December 31, 2004 were 12.49 percent, 9.68 percent and 8.39 percent, respectively.

An FCA regulation empowers it to direct a transfer of funds or equities by one or more System institutions to another System institution under specified circumstances. The Association has not been called upon to initiate any transfers and is not aware of any proposed action under this regulation.

C. Description of Equities

The Association is authorized to issue or have outstanding Classes A and C Common Stock and nonvoting Class C Participation Certificates and such other classes of equity as may be provided for in amendments to the bylaws in such amounts as may be necessary to conduct the Association's business. All stock and participation certificates have a par or face value of five dollars ($5.00) per share.

The Association had the following shares outstanding at December 31, 2004:

		Shares Outstanding	
Class	**Protected**	**Number**	**Aggregate Par Value**
A Preferred/Nonvoting	No	14,562	$ 73
C Common/Voting	No	680,163	3,401
C Participation Certificates/Nonvoting	No	89,975	450
Total Capital Stock and Participation Certificates		784,700	$ 3,924

At-risk common stock and participation certificates are retired at the sole discretion of the Board at book value not to exceed par or face amounts, provided the minimum capital adequacy standards established by the Board are met.

Retained Earnings

The Association maintains an unallocated retained earnings account and an allocated retained earnings account. The minimum aggregate amount of these two accounts is determined by the Board. At the end of any fiscal year, if the retained earnings accounts otherwise would be less than the minimum amount determined by the Board as necessary to maintain adequate capital reserves to meet the commitments of the Association, the Association shall apply earnings for the year to the unallocated retained earnings account in such amounts as may be determined necessary by the Board.

The Association maintains an allocated retained earnings account consisting of earnings held and allocated to borrowers on a patronage basis. In the event of a net loss for any fiscal year, such allocated retained earnings account will be subject to full impairment in the order specified in the bylaws beginning with the most recent allocation.

The Association has a first lien and security interest on all retained earnings account allocations owned by any borrowers, and all distributions thereof, as additional collateral for their indebtedness to the Association. When the debt of a borrower is in default or is in the process of final liquidation by payment or otherwise, the Association, upon approval of the Board, may order any and all retained earnings account allocations owned by such borrower to be applied on the indebtedness.

Allocated equities shall be retired solely at the discretion of the Board; provided, however, that minimum capital standards established by the FCA and the Board are met.

At December 31, 2004, allocated members' equity consisted of $1,787 of qualified surplus and $2,601 of nonqualified allocated surplus.

Patronage Distributions

Prior to the beginning of any fiscal year, the Board, by adoption of a resolution, may obligate the Association to distribute to borrowers on a patronage basis all or any portion of available consolidated net earnings of the Association and it subsidiaries for such fiscal year or for that and subsequent fiscal years.

If the Association meets its capital adequacy standards after making the patronage distributions, the patronage distributions may be in cash, authorized stock of the Association, allocations of earnings retained in an allocated members' equity account, or any one or more of such forms of distribution. Patronage distributions of the Association's earnings may be paid on either a qualified or nonqualified basis, or a combination of both, as determined by the Board.

A minimum of 20 percent of the total qualified patronage distribution to any borrower for any fiscal year shall always be paid in cash.

Earnings' pools, if any, that may be established upon approval by the Board for the payment of patronage distributions, shall be established on a rational and equitable basis and shall insure that each patron of the Association receives its fair share of the earnings of the Association and bears its fair share of the expenses of the Association.

Dividends

The Association may declare noncumulative dividends on its stock and participation certificates as determined by the Board's resolution. No dividend shall exceed eight percent (8 percent) per annum of the par value of the respective stock and Participation Certificates.

The rate of dividends paid on Class A Common Stock, Class C Common Stock and Participation Certificates shall be the same for any fiscal year.

Dividends may not be declared if, after recording the liability, the Association would not meet its capital adequacy standards. No dividends were declared by the Association for any of the periods included in these financial statements.

Transfer

Common Stocks and Participation Certificates may be transferred to persons or entities eligible to purchase or hold such equities.

Impairment

Any losses which result in an impairment of the Association's capital shall be borne ratably by, each share of Class A Common Stock, Class C Common Stock, and unit of Participation Certificates outstanding until the full par value of face amount of each such share or unit has been fully impaired; and then to preferred stock outstanding, if any, until the full par value of such has been impaired, all as of the date such losses are determined.

Liquidation

In the event of liquidation or dissolution of the Association, any assets of the Association remaining after payment or retirement of all liabilities should be distributed to the holders of the outstanding stock and participation certificates in the following order:

1. Preferred Stock, if any.

2. Classes A and C Common Stock and Participation Certificates.

3. Holders of allocated retained earnings evidenced by qualified written notices of allocation, in the order of year of issuance until an amount equal to the total account has been distributed.

4. Holders of allocated retained earnings evidenced by nonqualified written notices of allocation, in the order of the year of issuance, until an amount equal to the total account has been distributed.

5. Remaining assets shall be distributed to all past and present patrons in proportion to which the aggregate patronage of each party bears to the total patronage of all such parties, to the extent practicable, unless otherwise provided by law.

D. Other Comprehensive Income (Loss)

The Association reports other comprehensive income (loss) in its Statement of Changes in Members' Equity. For the years ended December 31, 2003 and 2002, other comprehensive income (loss) is related to the minimum pension liability recorded as a result of the funded status of the underlying plan. During 2004, the District Associations funded the pension plans sufficiently to eliminate the pension-related charge to other comprehensive income (loss) at December 31, 2004. See Note 10 for further information.

Note 9 — Income Taxes

The provision (benefit) for income taxes follows:

	Year Ended December 31, 2004	2003	2002
Current:			
Federal	$ (1)	$ —	$ (198)
State	—	—	—
Federal refunds related to long-term lending	—	(4)	(120)
	(1)	(4)	(318)
Deferred:			
Federal	—	108	198
State	—	—	—
	—	108	198
Total provision (benefit) for income taxes	$ (1)	$ 104	$ (120)

The provision (benefit) for income tax differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as follows:

	December 31, 2004	2003	2002
Federal tax at statutory rate	$ 1,226	$ 573	$ 526
Patronage distributions	(322)	(298)	(306)
Tax-exempt FLCA earnings	(569)	(627)	(900)
Long-term lending related refunds	—	—	(120)
Change in deferred tax asset valuation allowance	108	590	1,246
Allowance for loan loss adjustment	(370)	—	—
Net operating loss – carryback	—	(72)	(292)
Other	(74)	(62)	(274)
Provision (benefit) for income taxes	$ (1)	$ 104	$ (120)

Deferred tax assets and liabilities result from the following at:

	December 31, 2004	2003	2002
Allowance for loan losses	$ 184	$ 210	$ 213
Net operating loss – carryforward	1,237	1,132	838
Organizational costs	9	12	9
Nonaccrual loan interest	—	2	2
Nonqualified patronage distributions	1,044	796	567
Gross deferred tax assets	2,474	2,152	1,629
Valuation allowance	(2,047)	(1,939)	(1,349)
State income tax	(125)	(118)	(96)
Loan fees	(302)	(95)	(78)
Depreciation	—	—	2
Gross deferred tax liability	(427)	(213)	(172)
Net deferred tax asset (liability)	$ —	$ —	$ 108

At December 31, 2004, deferred income taxes have not been provided by the Association on approximately $1.3 million of patronage refunds received from the Bank prior to January 1, 1993. Such refunds, distributed in the form of stock, are subject to tax only upon conversion to cash. The tax liability related to future conversions is not expected to be material.

Note 10 — Employee Benefit Plans

The Association participates in a Districtwide defined benefit retirement plan. This plan is noncontributory and covers substantially all Association employees. Benefits are based on salary and years of service. The assets, liabilities and 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 the Association's salary expense as a percentage of the District's salary expense.

At December 31, 2004, the fair value of the plan assets of the District's defined benefit plan exceeded the Accumulated Benefit Obligation (ABO), while at December 31, 2003 and 2002, the ABO of the District's defined benefit plan exceeded the fair value of plan assets. The fair value of the plan assets and the ABO were measured as of September 30, 2004. At December 31, 2003 and 2002, the Association's allocated amount of the minimum pension liability was recorded in the Consolidated Balance Sheets in the amount of the excess of the ABO over the fair value of plan assets. In conjunction with the minimum pension liability, accumulated other comprehensive loss was $1,322 and $1,527 at December 31, 2003 and 2002, respectively. The impact on deferred taxes was not significant.

The Association also participates in a districtwide Thrift Plan. The Thrift Plan requires the Association to match 100 percent of employee optional contributions up to a maximum employee contribution of 6 percent of total compensation.

The District sponsors a plan providing certain benefits (primarily health care) to its retirees. Certain Association charges related to this plan are an allocation of District charges based on the Association's proportional share of the plan liability.

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act) was signed into law. This act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. In May 2004, the FASB issued FASB Staff Position ("FSP") 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" (the "Act"). This Staff Position provides guidance on the accounting for the effects of the Act for employers that sponsor postretirement health care plans that provide prescription drug benefits. The District sponsored plan adopted FSP 106-2 effective July 1, 2004 (measured as of March 31, 2004), and, accordingly, the benefit obligation valuation as of December 31, 2004 reflects the impact of the Medicare Act. For Medicare-eligible participants receiving actuarially equivalent drug benefits, the expected per capita claims cost are estimated to be reduced by 12 percent beginning in 2006 due to a government reimbursement of a portion of prescription drug benefits. Subsidies under the Medicare Act will reduce the current period measurements of benefits expected to be provided in future periods. Due to the status of the plan and the assumptions used in the remeasurement upon adoption of FSP 106-2, there was no effect on expense for 2004.

The following is a table of retirement and postretirement benefits expenses (credits):

	2004	2003	2002
Pension	$ 463	$ 389	$ 211
Thrift/deferred compensation	125	114	91
Other postretirement benefits	187	189	128
Total	$ 775	$ 692	$ 430

As of December 31, 2004, the Association had contributed $1,996 to the Districtwide defined benefit retirement plan, which was sufficient to meet its accumulated benefit obligation. The contributions eliminated the minimum pension liability and the pension-related charge to accumulated other comprehensive income (OCI) in shareholders' equity. As a result of the funding and the reclassification of the OCI, the Association ended 2004 with $1,751 in prepaid retirement expense in other assets on the consolidated balance sheets.

Note 11 — Intra-System Financial Assistance

The Farm Credit System Financial Assistance Corporation (Financial Assistance Corporation) was established in 1988 primarily to provide capital to institutions of the System experiencing financial difficulty. Such assistance was funded through the Financial Assistance Corporation's issuance of $1.261 billion of 15-year U.S. Treasury-guaranteed debt. The interest rates on these issuances range from 8.80 percent to 9.45 percent. The repayment of this debt and related interest is the responsibility of System banks. At December 31, 2004, $325 million of Financial Assistance Corporation debt remains outstanding and will mature in June 2005. All other debt has either matured or was called and redeemed.

Each System bank may be required to pay premiums into the Insurance Fund based on its annual average loan principal outstanding. The Bank, in turn, may also assess the Association for insurance premiums based on the average principal outstanding of accrual and nonaccrual loans of the Association for each year. At December 31, 2004, the assets in the Insurance Fund aggregated $2.164 billion. However, due to the authorized uses of the Insurance Fund, there is no assurance that Fund assets will be available or sufficient to ensure the payment of principal of, or interest on, insured debt securities in the event of a default by any System bank having primary liability thereon.

Note 12 — Related Party Transactions

In the ordinary course of business, the Association enters into loan transactions with officers and directors of the Association, their immediate families and other organizations with which such persons may be associated. Such loans are subject to special approval requirements contained in the FCA regulations and are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated borrowers.

Total loans to such persons at December 31, 2004 amounted to $2,720. During 2004, $1,225 of new loans were made and repayments totaled $598. In the opinion of management, none of these loans outstanding at December 31, 2004 involved more than a normal risk of collectibility.

Note 13 — Commitments and Contingencies

The Association has various commitments outstanding and contingent liabilities.

The Association may participate in financial instruments with off-balance-sheet risk to satisfy the financing needs of its borrowers and to manage their exposure to interest-rate risk. These financial instruments include commitments to extend credit and/or commercial letters of credit. The instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the financial statements. Commitments to extend credit are agreements to lend to a borrower as long as there is not a violation of any condition established in the contract. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2004, $20,000 of commitments to extend credit and $102 of standby letters of credit were outstanding.

Since many of these commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. However, these credit-related financial instruments have off-balance-sheet credit risk because their amounts are not reflected on the Balance Sheet until funded or drawn upon. The credit risk associated with issuing commitments and letters of credit is substantially the same as that involved in extending loans to borrowers and management applies the same credit policies to these commitments. Upon fully funding a commitment, the credit risk amounts are equal to the contract amounts, assuming that borrowers fail completely to meet their obligations and the collateral or other security is of no value. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower.

The Association also participates in standby letters of credit to satisfy the financing needs of its borrowers. These letters of credit are irrevocable agreements to guarantee payments of specified financial obligations. Outstanding standby letters of credit have expiration dates ranging from March 28, 2008 to June 23, 2009.

Note 14 — Disclosures About Fair Value of Financial Instruments

The following table presents the carrying amounts and fair values of the Association's financial instruments at December 31, 2004, 2003 and 2002. The fair value of a financial instrument is generally defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Quoted market prices are generally not available for certain System financial instruments, as described below. Accordingly fair values are based on judgments regarding anticipated cash flows, future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The estimated fair values of the Association's financial instruments are as follows:

	December 31, 2004		December 31, 2003	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash	$ 381	$ 381	$ 706	$ 706
Loans	$ 171,768	$ 172,323	$ 153,411	$ 154,879
Allowance for loan losses	828	—	2,826	—
Loans, net	$ 170,940	$ 172,323	$ 150,585	$ 154,879
Financial liabilities:				
Notes payable to AgFirst Farm Credit Bank	$ 157,765	$ 155,834	$ 137,721	$ 136,232

	December 31, 2002	
	Carrying Amount	Estimated Fair Value
Financial assets:		
Cash	$ 211	$ 211
Loans	$ 137,434	$ 142,207
Allowance for loan losses	2,773	—
Loans, net	$ 134,661	$ 142,207
Financial liabilities:		
Notes payable to AgFirst Farm Credit Bank	$ 122,606	$ 124,431

A description of the methods and assumptions used to estimate the fair value of each class of the Association's financial instruments for which it is practicable to estimate that value follows:

A. **Cash:** The carrying value is a reasonable estimate of fair value.

B. **Loans:** Because no active market exists for the Association's loans, fair value is estimated by discounting the expected future cash flows using the Association's current interest rates at which similar loans would be made to borrowers with similar credit risk. As the discount rates are based on the Bank's loan rates, as well as management estimates, management has no basis to determine whether the fair values presented would be indicative of the value negotiated in an actual sale.

   For purposes of determining fair value of accruing loans, the loan portfolio is segregated into pools of loans with homogeneous characteristics based upon repricing and credit risk. Expected future cash flows and interest rates reflecting appropriate credit risk are separately determined for each individual pool.

   Fair value of loans in a nonaccrual status is estimated to be the carrying amount less specific reserves.

   The carrying value of accrued interest approximates its fair value.

C. **Investment in AgFirst Farm Credit Bank:** Estimating the fair value of the Association's investment in the Bank is not practicable because the stock is not traded. As described in Note 5, the net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying balance sheet. The Association owns 1.23 percent of the issued stock of the Bank as of December 31, 2004 net of any reciprocal investment. As of that date, the Bank's assets totaled $16.9 billion and shareholders' equity totaled $1,024 million. The Bank's earnings were $180 million during 2004.

D. **Notes Payable to AgFirst Farm Credit Bank:** The notes payable are segregated into pricing pools according to the types and terms of the loans (or other assets) which they fund. Fair value of the notes payable is estimated by discounting the anticipated cash flows of each pricing pool using the current rate that would be charged for additional borrowings. For purposes of this estimate it is assumed the cash flow on the notes is equal to the principal payments on the Association's loan receivables plus accrued interest on the notes payable. This assumption implies that earnings on the Association's interest margin are used to fund operating expenses and capital expenditures.

E. **Commitments to Extend Credit and Standby Letters of Credit:** The estimated market value of off-balance-sheet commitments is minimal since the committed rate approximates current rates offered for commitments with similar rate and maturity characteristics and since the related credit risk is not significant.

Note 15 — Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2004, 2003 and 2002 follow:

2004	First	Second	Third	Fourth	Total
Net interest income	$ 854	$ 857	$ 884	$ 922	$ 3,517
Provision for (reversal of) loan losses	—	—	—	(2,000)	(2,000)
Noninterest income (expense), net	(632)	(517)	(477)	(284)	(1,910)
Net income (loss)	$ 222	$ 340	$ 407	$ 2,638	$ 3,607

2003	First	Second	Third	Fourth	Total
Net interest income	$ 729	$ 735	$ 810	$ 845	$ 3,119
Provision for (reversal of) loan losses	—	50	—	—	50
Noninterest income (expense), net	(312)	(188)	(250)	(737)	(1,487)
Net income (loss)	$ 417	$ 497	$ 560	$ 108	$ 1,582

2002	First	Second	Third	Fourth	Total
Net interest income	$ 565	$ 801	$ 625	$ 670	$ 2,661
Provision for (reversal of) loan losses	—	51	106	72	229
Noninterest income (expense), net	(298)	(324)	(306)	164	(764)
Net income (loss)	$ 267	$ 426	$ 213	$ 762	$ 1,668