
VALLEY FARM CREDIT, ACA

2007 ANNUAL REPORT

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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

Thanks to your support, Valley Farm Credit is pleased to report that its 2007 operating year was successful. The Rural Lending Division (farm loans) had another growth year in loan volume. The Residential Lending Division (home loans) sustained a difficult year with a significant slow down in the residential market. Operating income exceeded our mid-year expectations as 2007 income reached \$1,904,000. The objective that was set in the business plan for 2007 was \$1,973,000.

Our commitment to agriculture and the area's farm families has not diminished. Loan volume was \$174,590,000 at December 31, 2007 for agriculture, part-time farm, and residential loans. Business development in 2007 was active with loans in the agriculture, part-time farm, and residential loan portfolio. During the year, the Association's activity in the sold participation loan market continued from the prior year. The sale of loans in our portfolio serves to strengthen the Association's capital and liquidity position, and was required in certain instances to maintain appropriate association hold limits on loan volumes to members. Loan demand remains diversified and came from all branches. Commercial farm and part-time farm loan growth was complimented by residential construction lending.

The residential group had a challenging year. Originations of home loans held for sale amounted to \$46,921,000 down from \$61,378,000 in 2006. A substantial market correction, buyers who became cautious when fuel prices increased, and a fear of increasing interest rates combined to account for the most dramatic decline in real estate sales in several decades. Even with the challenging residential market, the Association continues to actively seek a role in the marketplace for the origination of housing loans to be sold into the secondary market. The marketplace for this product is highly competitive and requires continued emphasis throughout the coming year.

Business goals for 2008 have been set to reflect continued growth in the portfolio and commitment to member service. Portfolio growth is expected to be 5.5% in 2008. Growth opportunities in the residential division are expected to remain static in 2008 with levels similar to 2007.

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 remained low.

The local 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 business growth. Interest rates have provided stability to the lending environment. Interest rates increased in 2007, but remained competitive when compared to historical rates over the previous ten-year period. Farm producers were able to manage their financial affairs with lower costs as a result of reasonable total interest expense. We expect business results for the Association in 2008 to remain strong.

We strive to deliver exceptional service, and continually review our operations in search of ways to improve our efficiency and better serve your needs. We continue to utilize credit scoring programs, which streamline the approval process on smaller loans. The programs have successfully allowed us to deliver credit to our membership quickly and efficiently, while maintaining high quality standards.

We also ask each of you to utilize a number of programs designed to save you time and to save your organization money. These programs include AutoDraft, AgSweep, Internet Account Access, and AgriLine[®] to name a few. Check with your conveniently located branch office on how each of these can benefit you.

The Association's performance would not be possible without members like you. I want to thank you for telling the Valley Farm Credit story to your friends and neighbors. I also want to thank the staff for their hard work, dedication and contributions during the year. As a financial cooperative, we are dependent on your successes which have been many over the past year, and we hope you have a prosperous 2008.



Robert N. Carpenter
President/Chief Executive Officer

February 28, 2008

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 (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 2007 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.

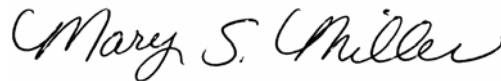
The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.



Charles W. Kackley
Chairman of the Board



Robert N. Carpenter
Chief Executive Officer



Mary S. Miller
Chief Financial Officer

February 28, 2008

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, 2007 with comparisons to the years ended December 31, 2006 and December 31, 2005. 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 accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors. For a list of the Audit Committee members, refer to the "Report of the Audit Committee" reflected in this Annual Report. Information in any part of this Annual Report may be incorporated by reference in answer or partial answer to any other item of the Annual Report.

The Association is an institution of the Farm Credit System (System), which was created by Congress in 1916 and has served agricultural producers for over 90 years. The System's 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 System is the largest agricultural lending organization in the United States. The 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 (also referred to throughout this Annual Report as stockholders or shareholders) served. The territory of the Association extends across a diverse agricultural region of five counties in Northern Virginia and three counties in the Eastern Panhandle of West Virginia. Refer to Note 1, "Organization and Operations," 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 residents, and agribusinesses. 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 (AgFirst or Bank). The Association is materially affected and shareholder investment in the Association could be affected by the financial condition and results of operations of the Bank. Copies of the Bank's Annual and Quarterly Reports are on the AgFirst website, www.agfirst.com, or may be obtained at no charge by calling 1-800-845-1745, extension 378, or writing Stephen Gilbert, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202.

Copies of the Association's Annual and Quarterly reports are also available upon request free of charge on the Association's website, www.valleyfc.com, or by calling 1-800-999-5341, extension 133, or writing Mary S. Miller, Vice President – Chief Financial Officer, Valley Farm Credit, ACA, P.O. Box 2700, Winchester, VA 22604. The Association prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Association.

FORWARD LOOKING INFORMATION

This annual information statement contains forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Words such as "anticipates," "believes," "could," "estimates," "may," "should," "will," or other variations of these terms are intended to identify the forward-looking statements. These statements are based on assumptions and analyses made in light of experience and other historical trends, current conditions, and expected future developments. However, actual results and developments may differ materially from our expectations and predictions due to a number of risks and uncertainties, many of which are beyond our control. These risks and uncertainties include, but are not limited to:

- political, legal, regulatory and economic conditions and developments in the United States and abroad;
- economic fluctuations in the agricultural, rural utility, international, and farm-related business sectors;
- weather-related, disease, and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- changes in United States government support of the agricultural industry; and
- actions taken by the Federal Reserve System in implementing monetary policy.

AGRICULTURAL OUTLOOK

In November 2007, the United States Department of Agriculture (USDA) estimated that 2007 farmers' net cash income (a measure of cash income after payment of business expenses) increased to \$85.7 billion, up \$17.8 billion from the 2006 forecast and up \$20.3 billion from its 10 year average. Contributing to this sizeable increase in net cash income were increases in cash receipts for crops and livestock of \$22.6 billion and \$20.3 billion, respectively, an increase in farm-related income of \$300 million, offset in part by an increase in cash expenses of \$21.7 billion and a decrease in direct government payments of \$3.7 billion. Corn prices have risen as a result of a combination of continued food and feed demand and expanding ethanol demand. Other crop prices, in general, were positively impacted by increased acreage used to plant corn, decreasing the amount of acreage available for other crops. Wheat and soybeans compete with corn as a feed source so both wheat and soybean prices have risen since late 2006. Livestock cash receipts increased as domestic and export demand for beef have risen. The following table, which is based on information published by the USDA, sets forth the commodity prices per bushel for certain crops and by hundredweight for beef cattle from December 31, 2004 to December 31, 2007:

Commodity	12/31/04	12/31/05	12/31/06	12/31/07
Corn	\$2.04	\$1.92	\$3.01	\$3.76
Soybeans	\$5.45	\$5.77	\$6.18	\$10.00
Wheat	\$3.39	\$3.54	\$4.52	\$7.74
Beef Cattle	\$86.80	\$93.30	\$83.10	\$88.90

Rising commodity prices can have both positive and negative impacts on the Association, as a lender to the agricultural and rural sectors. Higher commodity prices have resulted in increased seasonal demand for agribusiness loans. Higher grain prices positively impact grain farmers. However, higher feed costs negatively impact the profitability of livestock producers, as well as those who use corn or other grains as ingredients in processed foods. To date, this has not significantly affected the Association's credit quality. In addition to higher feed costs, most other production cash expenses, such as fertilizer, seed, energy and labor costs, are forecast to rise further in 2008.

The USDA's 2007 income outlook showed a great deal of variation depending on farm size, geographic location and commodity specialties. While we utilized the USDA analysis to provide a general understanding of the U.S. agricultural economic outlook, this outlook does not take into account all aspects of our business.

The USDA classifies all farms into three primary categories: commercial farms, intermediate farms and rural residential farms. Commercial farms represent about 11 percent of U.S. farms by number and represent 75 percent of total U.S. farm production. Intermediate farms (where the primary occupation is farming and gross sales are below \$250,000 (in dollars)) represent 26 percent of U.S. farms by number and account for 16 percent of total production. The remaining 63 percent of U.S. farms are classified as rural residential farms and only account for 9 percent of total production.

In addition to farmers' net cash income, off-farm income is an important source of repayment for farm debt obligations and is less subject to cycles in agriculture. The USDA measures farm household income, which is defined as earnings from farming activities plus off-farm income. Nearly 100 percent of farm household income for operators of rural residential farms and more than 80 percent of farm household income for intermediate farms is generated from off-farm sources. Further, USDA data suggests that about 30 percent of farm household income for commercial farms is generated from off-farm income. USDA estimated 2007 farm household income to increase 21 percent for commercial farms, 8 percent for intermediate farms and 4 percent for rural residential farms.

According to the USDA, farm business balance sheets have shown improvement over the last few years, as measured by debt relative to assets and equity levels. Farmers' equity (farm business assets less farm business debt) is expected to have increased in 2007. One measure of the financial health of the agricultural sector used by the USDA is the assessment of farmers' utilization of their capacity to repay debt (actual debt as a percentage of maximum debt that can be supported by farmers' current income). Higher capacity utilization rates indicate tighter cash flow positions and, consequently, higher exposure to financial risk. These estimates do not take into account, however, off-farm income sources. Since 1970, debt repayment capacity utilization has ranged from a low of 35.8 percent in 1973 to 104.1 percent in 1981, and has remained relatively stable since 1987, averaging about 50 percent. The USDA suggests a decrease in the use of repayment capacity from 57 percent in 2006 to 48 percent in 2007.

Farm business debt, defined by the USDA as debt incurred by those involved in on-farm agricultural production, is estimated to have grown 3.8 percent in 2007, the fourth consecutive year of rising farm debt, following a rise of 7.3 percent in 2006. The recent rise in debt can be at least partially attributed to farmers' positive view of the sector's future. Farm real estate debt accounted for approximately 53 percent of all farm debt for 2007 and 2006.

In general, agriculture has experienced a long period of favorable economic conditions, due to stronger commodity prices, higher land values, and, to a lesser extent, government support programs. To date, the Association's financial results and credit quality have been positively impacted by these conditions. Production agriculture, however, remains a cyclical business that is heavily influenced by commodity prices. In some areas, land values recently have been negatively affected by less favorable economic conditions. Economic conditions in agriculture may not be as favorable in the near future. In an environment of adverse economic conditions in agriculture and without sufficient government support programs, the Association's financial performance and credit quality measures would likely be negatively impacted. However, any negative impacts should be lessened by geographic and commodity diversification and the substantial influence of off-farm income sources supporting agricultural-related debt.

CRITICAL ACCOUNTING POLICIES

The financial statements are reported in conformity with accounting principles generally accepted in the United States of America. Our significant accounting policies are critical to the understanding of our results of operations and financial position because some accounting policies require us to make complex or subjective judgments and estimates that may affect the value of certain assets or liabilities. We consider these policies critical because management must make judgments about matters that are inherently uncertain. For a complete discussion of significant accounting policies, see Note 2, "Summary of Significant Accounting Policies," of the Notes to the Consolidated Financial Statements. The following is a summary of certain critical policies.

- *Allowance for loan losses* — The allowance for loan losses is management's best estimate of the amount of probable losses existing in and inherent in our loan portfolio. The allowance for loan losses is increased through provisions for loan losses and loan recoveries and is decreased through allowance reversals and loan charge-offs. The allowance for loan losses is determined based on a periodic evaluation of the loan portfolio, which generally considers relevant historical charge-off experience adjusted for relevant factors. These factors include types of loans, credit quality, specific industry conditions, general economic and political conditions, and changes in the character, composition, and performance of the portfolio, among other factors.

Significant individual loans are evaluated based on the borrower's overall financial condition, resources, and payment record, the prospects for support from any financially responsible guarantor, and, if appropriate, the estimated net realizable value of any collateral. The allowance for loan losses attributable to these loans is established by a process that estimates the probable loss inherent in the loans, taking into account various historical and projected factors, internal risk ratings, regulatory oversight, and geographic, industry and other factors.

Changes in the factors considered by management in the evaluation of losses in the loan portfolios could result in a change in the allowance for loan losses and could have a direct impact on the provision for loan losses and the results of operations.

- *Valuation methodologies* — Management applies various valuation methodologies to assets and liabilities that often involve a significant degree of judgment, particularly when liquid markets do not exist for the particular items being valued. Quoted market prices are referred to when estimating fair values for certain assets for which an observable liquid market exists, such as most investment securities. Management utilizes significant estimates and assumptions to value items for which an observable liquid market does not exist. Examples of these items include impaired loans, pension and other postretirement benefit obligations, and certain other financial instruments. These valuations require the use of various assumptions, including, among others, discount rates, rates of return on assets, repayment rates, cash flows, default rates, costs of servicing and liquidation

values. The use of different assumptions could produce significantly different results, which could have material positive or negative effects on the Association's results of operations.

- *Pensions* — The Bank and its related Associations participate in defined benefit retirement plans. These plans are noncontributory and benefits are based on salary and years of service. In addition, the Bank and its related Associations also participate in defined contribution retirement savings plans. Pension expense for all plans is recorded as part of salaries and employee benefits. Pension expense for the defined benefit retirement plans is determined by actuarial valuations based on certain assumptions, including expected long-term rate of return on plan assets and discount rate. The expected return on plan assets for the year is calculated based on the composition of assets at the beginning of the year and the expected long-term rate of return on that portfolio of assets. The discount rate is used to determine the present value of our future benefit obligations. We selected the discount rate by reference to Hewitt's corporate bond index, actuarial analyses and industry norms.

ECONOMIC CONDITIONS

During 2007, economic conditions in our region were relatively stable, despite nationwide adversity in housing and related markets. Although local home sale volume has declined, and this has significantly reduced the Association's sale of related loans into the secondary market, loan volume related to agricultural operations has remained steady. The Association continues to have a large segment of farm borrowers with supplemental off-farm income, and the local general economy outside the housing sector remained strong due in large part to proximity to the nation's capital and related government and technology industries. Unemployment remained low, and the local population trends remained in a growth mode. Commercial land and lifestyle farm activity remained strong throughout the year and remain focus areas for the Association.

LOAN PORTFOLIO

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

The diversification of the Association loan volume by type for each of the past three years is shown below.

Loan Type	2007		December 31, 2006		2005	
			(dollars in thousands)			
Real estate mortgage	\$ 81,305	46.57%	\$ 72,897	42.18%	\$ 78,434	40.00%
Production and intermediate-term	73,730	42.23	77,433	44.80	62,628	48.80
Processing and marketing	2,101	1.20	1,805	1.04	2,230	2.45
Farm-related business	1,093	0.63	1,801	1.04	1,901	1.13
Rural residential real estate	16,361	9.37	18,907	10.94	16,995	7.11
Total	\$ 174,590	100.00%	\$ 172,843	100.00%	\$ 162,188	100.00%

While we make loans and provide financially related services to qualified borrowers in the agricultural and rural sectors and to certain related entities, our loan portfolio is diversified.

The geographic distribution of the loans by branch/state for the past three years is as follows:

Branch/State	December 31,		
	2007	2006	2005
Winchester, VA	*44%	*43%	*39%
Martinsburg, WV	22	22	22
Woodstock, VA	34	35	39
Total	100%	100%	100%

*Includes participations purchased

Commodity and industry categories are based upon the Standard Industrial Classification system published by the federal government. The system is used to assign commodity or industry categories based upon the largest agricultural commodity of the customer.

The major commodities in the Association loan portfolio are shown below. The predominant commodities are livestock, poultry, and part-time farm and other, which constitute 79 percent of the entire portfolio.

Commodity Group	December 31,					
	2007		2006		2005	
	<i>(dollars in thousands)</i>					
Part-time farm and other	\$ 63,445	36%	\$ 62,224	36%	\$ 53,522	33%
Livestock	46,624	27	43,211	25	40,547	25
Poultry	28,756	16	29,383	17	32,438	20
Rural Home	15,567	9	17,284	10	14,597	9
Orchards	10,832	7	12,099	7	11,353	7
Dairy	9,366	5	8,642	5	9,731	6
Total	\$ 174,590	100%	\$ 172,843	100%	\$ 162,188	100%

Repayment ability is closely related to the commodities produced by our borrowers, and increasingly, the off-farm income of borrowers. The largest concentration in the Association's loan portfolio is part-time farmers, with crops (primarily hay) and general livestock being the major commodity areas for these part-time farm operations. These part-time farm operations have a high dependency on non-farm income sources, and these sources remain mostly stable in the Associations' service territory despite an overall softening in the general economy. Full-time farm operations with relatively high portfolio concentrations are poultry, dairy and orchard operations; risk in the poultry segment is balanced with government guarantees, and the majority of dairy and orchard operations have diversification with other commodities and/or solid balance sheet positions. Increase in loan demand over the last several years has been primarily in the part-time farm segment, with broad commodity segmentation and significant non-farm income support. Risk in the loan portfolio is managed through underwriting standards specific to areas of concentration, internal lending limits and sound portfolio management and monitoring practices.

The Associations' growth in recent years has been primarily attributable to an increase in loan volume in the lifestyle farm area. This is reflective of continued transition in the local economy from a primarily rural area to a threshold community for the Washington, DC market. The Association's full-time farmer base remains stable, with high market saturation in this area.

During 2007, the Association increased activity in the buying and selling of loan participations within and outside of the System. 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.

Loan Participations:	December 31,		
	2007	2006	2005
	<i>(dollars in thousands)</i>		
Participations Purchased			
– FCS Institutions	\$ 4,328	\$ 2,359	\$ 2,184
Participations Purchased			
– Non-FCS Institutions	–	–	–
Participations Sold	(17,649)	(48,798)	(16,193)
Total	\$ (13,321)	\$ (46,439)	\$ (14,009)

The Association did not have any loans sold with recourse, retained subordinated participation interests in loans sold, or interests in pools of subordinated participation interests for the period ended December 31, 2007.

The Association sells qualified long-term mortgage loans into the secondary market. For the period ended December 31, 2007, the Association originated loans for resale totaling \$46,921, which were sold into the secondary market. The secondary mortgage market enables the Association to compete in the residential loan market without placing the burden on building capital and generating earnings to support this business on the agricultural sector.

The Association also participates in the Farmer Mac Long Term Stand-By program. Farmer Mac was established by Congress to provide liquidity to agricultural lenders. At December 31, 2007, the Association had loans amounting to \$6,818 which were 100 percent guaranteed by Farmer Mac, compared to \$8,749 at December 31, 2006 and \$9,691 at December 31, 2005. The Association additionally purchased portions of loans that are guaranteed by the United States Department of Agriculture. These loans are held for the purposes of reducing and managing risk as allowable under FCA regulations. At December 31, 2007, the balance of these loans was \$249, compared to \$0 at December 31, 2006 and \$0 at December 31, 2005. The Association continues to participate in Farm Service Agency (FSA) loan guarantee programs. At December 31, 2007, FSA guaranteed loan volume was \$12,977, compared to \$12,610 at December 31, 2006 and \$15,538 at December 31, 2005.

MISSION-RELATED INVESTMENTS

During 2005, the FCA initiated an investment program to stimulate economic growth and development in rural areas. The FCA outlined a program to allow System institutions to hold such investments, subject to approval by the FCA on a case-by-case basis. FCA approved the Rural America Bonds pilot and the Tobacco Buyout Program under the mission-related investments umbrella, as described below.

In October 2005, the FCA authorized AgFirst and the Associations to make investments in Rural America Bonds under a three-year pilot period. Rural America Bonds may include debt obligations issued by public and private enterprises, corporations, cooperatives, other financing institutions, or rural lenders where the proceeds would be used to support agriculture, agribusiness, rural housing, or economic development, infrastructure, or community development and revitalization projects in rural areas. Examples include investments that fund value-added food and fiber processors and marketers, agribusinesses, commercial enterprises that create and maintain employment opportunities in rural areas, community services, such as schools, hospitals, and government facilities, and other activities that sustain or revitalize rural communities and their economies. The objective of this pilot program is to help meet the growing and diverse financing needs of agricultural enterprises, agribusinesses, and rural communities by providing a flexible flow of money to rural areas through bond financing. These bonds may be classified as Loans or Investments on the Consolidated Balance Sheets depending on the nature of the investment. As of December 31, 2007 and December 31, 2006, the Association had \$559 and \$0, respectively, in Rural America Bonds, and they are classified as Loans on the Consolidated Balance Sheets.

CREDIT RISK MANAGEMENT

Credit risk arises from the potential inability of an obligor to meet its repayment obligation. As part of the process to evaluate the success of a loan, the Association continues to review the credit quality of the loan portfolio on an ongoing basis. With the approval of the Association Board of Directors, the Association establishes underwriting standards and lending policies that provide direction to loan officers. Underwriting standards include, among other things, an evaluation of:

- Character – borrower integrity and credit history
- Capacity – repayment capacity of the borrower based on cash flows from operations or other sources of income
- Collateral – protection for the lender in the event of default and a potential secondary source of repayment
- Capital – ability of the operation to survive unanticipated risks
- Conditions – intended use of the loan funds

The credit risk management process begins with an analysis of the borrower's credit history, repayment capacity, and financial position. Repayment capacity focuses on the borrower's ability to repay the loan based upon cash flows from operations or other sources of income, including non-farm income. Long-term real estate loans must be collateralized by first liens on the real estate (collateral). As required by FCA regulations, each institution that makes loans on a collateralized basis must have collateral evaluation policies and procedures. Real estate mortgage loans may be made only in amounts up to 85 percent of the original appraised value of the property taken as collateral or up to 97 percent of the appraised value if guaranteed by a state, federal, or other governmental agency. The actual loan to appraised value when loans are made is generally lower than the statutory maximum percentage. Appraisals are required for loans of more than \$250,000 (in

dollars). In addition, each loan is assigned a credit risk rating based upon the underwriting standards. This credit risk rating process incorporates objective and subjective criteria to identify inherent strengths, weaknesses, and risks in a particular relationship.

We review the credit quality of the loan portfolio on an ongoing basis as part of our risk management practices. Each loan is classified according to the Uniform Classification System, which is used by all Farm Credit System 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.

Credit Quality	2007	2006	2005
Acceptable & OAEM	98.22%	98.91%	97.96%
Substandard	1.78%	1.09%	2.04%
Doubtful	–%	–%	–%
Loss	–%	–%	–%
Total	100.00%	100.00%	100.00%

Nonperforming Assets

The Association's loan portfolio is divided into performing and high-risk categories. Loans classified as high risk require additional servicing time and efforts. The Association's level of high risk assets is relatively low. 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:

High-risk Assets	12/31/07	12/31/06	12/31/05
	<i>(dollars in thousands)</i>		
Nonaccrual loans	\$ 35	\$ –	\$ –
Restructured loans	–	–	–
Accruing loans 90 days past due	752	–	–
Accruing loans less than 90 days past due	34	–	–
Total high-risk loans	821	–	–
Other property owned	–	–	–
Total high-risk assets	\$ 821	\$ –	\$ –
Ratios			
Nonaccrual loans to total loans	0.02%	–%	–%
High-risk assets to total assets	0.43%	–%	–%

Nonaccrual loans represent all loans where there is a reasonable doubt as to the collection of principal and/or future interest accruals, under the contractual terms of the loan. In substance, nonaccrual loans reflect loans where the accrual of interest has been suspended. Nonaccrual loans increased \$35 or 100.00 percent in 2007. This increase resulted from one account classified as nonaccrual. Of the \$35 in nonaccrual volume at December 31, 2007, \$35 or 100.00 percent was current as to scheduled principal and interest payments, but did not meet all regulatory requirements to be transferred into accrual status. There were no nonaccrual loans in 2006 or 2005.

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.

Allowance for Loan Losses

The allowance for loan losses at each period end was considered by Association management to be adequate to absorb probable losses existing in and inherent to its loan portfolio.

The following table presents the activity in the allowance for loan losses for the most recent three years:

Allowance for Loan Losses Activity:	Year Ended December 31,		
	2007	2006	2005
	<i>(dollars in thousands)</i>		
Balance at beginning of year	\$ 594	\$ 710	\$ 828
Charge-offs:			
Real estate mortgage	(15)	—	—
Production and intermediate-term	—	—	(2)
Total charge-offs	(15)	—	(2)
Recoveries:			
Production and intermediate-term	—	—	2
Total recoveries	—	—	2
Net (charge-offs) recoveries	(15)	—	—
Provision for (reversal of allowance for) loan losses	(25)	(116)	(118)
Balance at end of year	\$ 554	\$ 594	\$ 710
Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period	(.009)%	—%	—%

The net loan charge-offs were primarily associated with one poultry loan.

The allowance for loan losses by loan type for the most recent three years is as follows:

Allowance for Loan Losses by Type	December 31,		
	2007	2006	2005
	<i>(dollars in thousands)</i>		
Real estate mortgage	\$ 195	\$ 188	\$ 257
Production and intermediate-term	299	329	361
Agribusiness	8	12	18
Rural residential real estate	52	65	74
Total	\$ 554	\$ 594	\$ 710

The allowance for loan losses as a percentage of loans outstanding and as a percentage of certain other credit quality indicators is shown below:

Allowance for Loan Losses as a Percentage of:	2007	2006	2005
Total loans	.32%	.34%	.34%
Nonperforming loans*	67%	N/A%	N/A%
Nonaccrual loans*	1583%	N/A%	N/A%

* There were no nonperforming or nonaccrual loans in 2006 or 2005.

The financial positions of our farm borrowers have generally strengthened during the past decade as farmers' net cash income has been at a favorable level due, in part, to direct federal government payments and steady increases in land values over the period. With borrowers' strengthened financial positions and the continued emphasis on sound underwriting standards, the credit quality of our loan portfolio has remained healthy. Please refer to Note 4, "Loans and Allowance for Loan Losses," of the Notes to the Consolidated Financial Statements, for further information concerning the allowance for loan losses.

RESULTS OF OPERATIONS

Net Interest Income

Net interest income was \$4,244, \$4,123 and \$3,957 in 2007, 2006 and 2005, respectively. Net interest income is the difference between income and interest expense. Net interest income is the principal source of earnings for the Association and is impacted by volume, yields on assets and cost of debt. The effects of changes in average volume and interest rates on net interest income over the past three years are presented in the following table:

Change in Net Interest Income:

	Volume*	Rate	Nonaccrual	
			Income	Total
	<i>(dollars in thousands)</i>			
12/31/07 - 12/31/06				
Interest income	\$ 528	\$ 499	\$ —	\$ 1,027
Interest expense	363	543	—	906
Change in net interest income	\$ 165	\$ (44)	\$ —	\$ 121
12/31/06 - 12/31/05				
Interest income	\$ (272)	\$ 1,590	\$ —	\$ 1,318
Interest expense	(108)	1,260	—	1,152
Change in net interest income	\$ (164)	\$ 330	\$ —	\$ 166

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

Noninterest Income

Noninterest income for each of the three years ended December 31 is shown in the following table:

Noninterest Income	For the Year Ended December 31,			Percentage Increase/(Decrease)	
	2007	2006	2005	2007/ 2006	2006/ 2005
	<i>(dollars in thousands)</i>				
Loan fees	\$ 290	\$ 319	\$ 357	(9)%	(11)%
Fees for financially related services	261	178	138	47	29
Patronage refund from other Farm Credit Institutions	1,749	1,575	1,745	11	(10)
Gains (losses) on sales of rural home loans	686	910	1,135	(25)	(20)
Gains (losses) from sales of premises and equipment, net	17	8	224	113	(96)
Gains (losses) on sales of other assets, net	—	177	283	(100)	(37)
Other noninterest income	237	182	109	30	67
Total noninterest income	\$ 3,240	\$ 3,349	\$ 3,991	(3)%	(16)%

Noninterest Expense

Noninterest expense for each of the three years ended December 31 is shown in the following table:

Noninterest Expense	For the Year Ended December 31,			Percentage Increase/(Decrease)	
	2007	2006	2005	2007/ 2006	2006/ 2005
	<i>(dollars in thousands)</i>				
Salaries and employee benefits	\$ 3,275	\$ 3,392	\$ 3,388	(3)%	—%
Occupancy and equipment expense	816	806	607	1	33
Insurance Fund premium	246	234	79	5	196
Other operating expense	1,303	1,255	1,409	4	(11)
Total noninterest income	\$ 5,640	\$ 5,687	\$ 5,483	(1)%	4%

Noninterest expense decreased \$47 or 1 percent for December 31, 2007, as compared to the same period of 2006 and increased \$204 or 4 percent compared to December 31, 2005. The Insurance Fund premium was the area that had the largest percentage increase from 2005 to 2006 increasing \$155 or 196 percent for December 31, 2006, as compared to the same period in 2005.

Income Taxes

The Association recorded a benefit for income taxes of \$35 for the year ended December 31, 2007, as compared to a benefit of \$2 for 2006 and a provision of \$4 for 2005. The tax benefits are primarily attributable to income tax refunds related to prior years.

Key Results of Operations Comparisons

Key results of operations comparisons for each of the twelve months ended December 31 are shown in the following table:

Key Results of Operations Comparisons	For the 12 Months Ended		
	12/31/07	12/31/06	12/31/05
Return on average assets	1.00%	1.04%	1.41%
Return on average members' equity	7.44%	7.99%	11.70%
Net interest income as a percentage of average earning assets	2.42%	2.45%	2.29%
Net charge-offs (recoveries) to average loans	0.009%	—%	—%

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 and Funding*

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement (GFA). The GFA 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 (or direct loans) to the Bank. The Bank manages interest rate risk through direct loan pricing and asset/liability management. 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. Association capital levels effectively create a borrowing margin between the amount of loans outstanding and the amount of notes payable outstanding. This margin is commonly referred to as "Loanable Funds".

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 the Bank and from income generated by operations. The liquidity policy of the Association is to manage cash balances to maximize debt reduction and to increase loan volume. As borrower payments are received, they are applied to the Association's note payable to the Bank. The Association's participation in the Farmer Mac, investments, and other secondary market programs provides additional liquidity. Sufficient liquid funds have been available to meet all financial obligations. There are no known trends likely to result in a liquidity deficiency for the Association.

Total notes payable to the Bank at December 31, 2007, was \$161,298 as compared to \$161,731 at December 31, 2006 and \$149,339 at December 31, 2005. The decrease of 0.27 percent compared to December 31, 2006 and the increase of 8.30 percent compared to December 31, 2005, was attributable to changes in loan volume and loanable funds in the Association. The average volume of outstanding notes payable to the Bank was \$162,941 and \$156,228 for the years ended December 31, 2007 and 2006, respectively. Refer to Note 6, "Notes Payable to AgFirst Farm Credit Bank," of the Notes to the Consolidated Financial Statements, for weighted average interest rates and maturities, and additional information concerning the Association's notes payable.

The Association had no lines of credit from third party financial institutions as of December 31, 2007.

Funds Management

The Bank and the Association manage assets and liabilities to provide a broad range of loan products and funding options, which are designed to allow 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.

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 market indices such as 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 System debt of similar terms to maturity.

The majority of the interest rate risk in the Association's Consolidated Balance Sheets 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.

CAPITAL RESOURCES

Capital serves to support asset growth and provide protection against unexpected credit and interest rate risk and operating losses. Capital is also needed for future growth and investment in new products and services.

The Association Board of Directors establishes, adopts, and maintains a formal written capital adequacy plan to ensure that adequate capital is maintained for continued financial viability, to provide for growth necessary to meet the needs of members/borrowers, and to ensure that all stockholders are treated equitably. There were no material changes to the capital plan for 2007 that would affect minimum stock purchases or would have an effect on the Association's ability to retire stock and distribute earnings.

Total members' equity at December 31, 2007, increased 5.35 percent to \$26,126 from the December 31, 2006, total of \$24,800. At December 31, 2006, total members' equity increased 6.99 percent from the December 31, 2005 total of \$23,180. The increase was primarily attributed to net income partially offset by cash patronage and the revolvment of allocated earnings.

Total capital stock and participation certificates were \$3,945 on December 31, 2007, compared to \$4,042 on December 31, 2006 and \$3,960 on December 31, 2005. The changes are attributed to the activity of stock purchases and retirements in the normal course of business.

FCA sets minimum regulatory capital requirements for System banks and associations. Capital adequacy is evaluated using a number of regulatory ratios. According to the FCA regulations, each institution's permanent capital ratio is calculated by

dividing permanent capital by a risk-adjusted asset base. Risk adjusted assets mean the total dollar amount of the institution's assets adjusted by an appropriate credit conversion factor as defined by regulation. For all periods represented, the Association exceeded minimum regulatory standard for all the ratios.

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

	2007	2006	2005	Regulatory Minimum
Permanent capital ratio	13.68%	14.19%	14.10%	7.00%
Total surplus ratio	11.17%	11.54%	11.28%	7.00%
Core surplus ratio	10.53%	10.63%	10.09%	3.50%

The decrease in the Association's permanent capital, total surplus, and core surplus for December 31, 2007 and December 31, 2006 was attributed to lower earnings and declines in guaranteed loan volume. There are no trends, commitments, contingencies, or events that are likely to affect the Association's ability to meet regulatory minimum capital standards and capital adequacy requirements.

See Note 7, "Members' Equity," of the Notes to the Consolidated Financial Statements, for further information concerning capital resources.

PATRONAGE PROGRAM

Prior to the beginning of any fiscal year, the Association's Board of Directors, by adoption of a resolution, may establish a Patronage Allocation Program to distribute its available consolidated net earnings. This resolution provides for the application of net earnings in the manner described in the Association's Bylaws. This includes the setting aside of funds to increase surplus to meet minimum capital adequacy standards established by FCA Regulations, to increase surplus to meet Association capital adequacy standards to a level necessary to support competitive pricing at targeted earnings levels, and for reasonable reserves for necessary purposes of the Association. After excluding net earnings attributable to (a) the portion of loans participated to another institution, and (b) participation loans purchased, remaining consolidated net earnings are eligible for allocation to borrowers. Refer to Note 7, "Members' Equity," of the Notes to the Consolidated Financial Statements, for more information concerning the patronage distributions. The Association declared patronage distributions of \$630 in 2007, \$497 in 2006, and \$525 in 2005.

YOUNG, BEGINNING AND SMALL (YBS) FARMERS AND RANCHERS PROGRAM

The Association's mission is to provide financial services to agriculture and the rural community, which includes providing credit to young, beginning and small (YBS) farmers. Because of the unique needs of these individuals, and their importance to the future growth of the Association, the Association has established annual marketing goals to sustain and increase our market share of loans to YBS farmers. Marketing plans have been developed to target these groups, and resources have been designated to help ensure YBS borrowers access to a stable source of credit. Ambitious loan origination goals are established and are generally met.

YBS farmers and ranchers are defined as:

Young farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who are age 35 or younger as of the date the loan is originally made.

Beginning farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who have 10 years or less farming or ranching experience as of the date the loan is originally made.

Small farmers are defined as those farmers, ranchers, producers or harvesters of aquatic products who normally generate less than \$250,000 (in dollars) in annual gross sales of agricultural or aquatic products at the date the loan is originally made.

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

	As of December 31, 2007	
	Number of Loans	Amount of Loans
Young	319	\$20,784
Beginning	743	71,438
Small	1,615	129,292

Note: 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 2002 USDA Ag census data has been used as a benchmark to measure penetration of the Association’s marketing efforts (2002 is the latest USDA Ag census data available; next census will be available in 2008). The census data indicated that within the Association’s chartered territory (counties) there were 4,419 reported farmers of which by definition 183 or 4.14 percent were Young, 1,221 or 27.63 percent were Beginning, and 4,146 or 93.82 percent were Small. Comparatively, as of December 31, 2007, the demographics of the Association’s agricultural portfolio contained 1,313 farmers, of which by definition 217 or 16.78 percent were Young, 531 or 40.44 percent were Beginning and 996 or 75.86 percent were Small.

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 are 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.

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 guarantors; use of cosigners, joint applicants, or pledged collateral from other individuals to reduce risk to the Association; and 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 alliance partnerships, 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 following strategies and outreach programs have been conducted to assist the Association to meet its young, beginning, and small farmer program goals and objectives. Continued work and enhancement of these strategies and programs are ongoing as the Association strives to meet its commitment to the future success of young, beginning and small farmers.

- Promotion of the “Youth in Agriculture” initiative includes supporting student and youth projects with the intent to educate youth about various career options and opportunities in agriculture. This includes, but is not limited to, numerous donations and sponsorships to 4-H, Future Farmers of America (FFA), and young farmer organization activities. Additionally, Association staff is encouraged to volunteer time to assist 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.
- Appointment of YBS coordinators in each Branch office of Valley Farm Credit.
- The Association actively utilizes FSA guaranteed programs to find methods to extend constructive credit to YBS farmers in proactive ways. About 6.7% of total Association loan volume consists of guaranteed FSA loans to young, beginning, and small farmers.

REGULATORY MATTERS

Proposed Federal Legislation

The current Farm Bill expired on September 30, 2007. In July 2007, the House of Representatives passed its version of a new Farm Bill, the Farm, Nutrition, and Bioenergy Act of 2007. Under the Farm Bill as passed by the House of Representatives, the Congressional Budget Office estimated that payments to farmers under the commodity programs (i.e., direct and countercycle payments and loan deficiency payments) would be reduced by an estimated \$825 million in total over the next 10 years, as compared with a current services baseline of approximately \$75 billion for commodities. However, the specific provisions of the Farm Bill may increase payments for certain commodities or increase them in certain years and reduce them in others. This Farm Bill would also revise certain income payment limitations.

The Farm Bill as passed by the House of Representatives also contains provisions that would expand certain authorities of the Farm Credit System Insurance Corporation. The proposed changes generally would authorize the Insurance Corporation to collect higher levels of premiums and expand the base upon which premiums are charged. Premiums of up to 20 basis points could be charged against insured debt, adjusted to exclude an amount equal to government-guaranteed loans and investment securities. Up to an additional 10 basis points could be charged for any loan volume that is nonaccrual or investments that are other-than-temporarily impaired. Currently, premiums of up to 15 basis points may be charged on accruing loans and up to 25 basis points on nonaccrual loans.

In December 2007, the Senate passed its version of the Farm Bill, the Food and Energy Security Act of 2007. As reported, the bill proposes adjustments to current farm policy while maintaining the basic safety net structure of current law. The bill, when combined with tax provisions previously reported by the Senate Finance Committee, would provide for a permanent disaster fund and provide new incentives for farmers to engage in soil conservation activities. Before these changes are enacted into law, the Senate must conference their actions with the bill earlier approved by the House. It is premature to predict the final outcome of this process. The Senate Farm Bill contains the same expanded authorities with respect to the Insurance Corporation as noted above.

The Senate has named conferees. Conference Committee deliberation, however, awaits the naming of House conferees before it can move forward.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109*" (FIN 48 or Interpretation) that was effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies how an enterprise should recognize, measure, present and disclose in its financial statements uncertain tax positions that the enterprise has taken or expects to take on a tax return. Under the Interpretation, the financial statements reflect expected future tax consequences of income tax positions presuming the relevant taxing authority's full knowledge of the position and all relevant facts, but without considering time values. FIN 48 is applicable to all uncertain positions for taxes accounted for under FASB Statement No. 109. The Association adopted FIN 48 on January 1, 2007 and determined that interest and penalties would be classified as a component of income taxes.

There were no uncertain positions for income taxes at January 1, 2007 identified as a result of the adoption and therefore no cumulative adjustment to beginning members' equity was required. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, "*Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans.*" The Standard requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through other comprehensive income. The Standard further requires the determination of the fair value of plan assets at year-end and recognition of actuarial gains and losses, prior service costs or credits, and transition assets and obligations as a component of other comprehensive income. In addition, this Standard requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the District uses a measurement date of September 30th. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. See Note 9, "Employee Benefit Plans," of the Notes to the Consolidated Financial Statements, for the impact of the adoption of FAS 158 on the current period.

In September 2006, the FASB also issued Statement of Financial Accounting Standards No. 157, "*Fair Value Measurements.*" This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. As a result, there is now a common definition of fair value to be used throughout generally accepted accounting principles. The FASB believes that the new standard will make the measurement of fair value more consistent and comparable and improve disclosures about those measures. This Statement clarifies that the term fair value is intended to mean a market-based measure, not an entity-specific measure. In measuring fair value for a financial statement item, the Statement sets forth a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The highest priority is given to quoted prices in active markets and the lowest priority to unobservable inputs. Additional disclosure requirements will be required for the lowest priority level. The Statement became effective as of January 1, 2008, and will be applied to our consolidated financial statements on a prospective basis.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "*Fair Value Option for Financial Assets and Financial Liabilities.*" The Standard permits entities to choose on an instrument-by-instrument basis, at specified election dates, to measure financial assets and liabilities and certain other items at fair value (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected must be reported in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. This Standard became effective as of January 1, 2008. The Association has not made any elections under the fair value option, thus there will be no impact of the initial adoption of the Standard. However, the Association may elect to apply the fair value option to financial instruments acquired in future periods.

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 of the Consolidated Financial Statements, "Organization and Operations," included in this Annual Report to shareholders.

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.

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:

<u>Location</u>	<u>Description</u>	<u>Form of Ownership</u>
125 Prosperity Drive Kernstown Business Park Winchester, VA	(1) Administrative/Branch 28,512 square feet	Owned
158 Crimson Circle Ridgefield Business Park Martinsburg, WV	(2) Branch 8,284 square feet	Owned
1031 S. Main Street Woodstock, VA	Branch 3,456 square feet	Owned
South Main Street Woodstock, VA	(3) Unimproved one acre lot – number 2 Shenandoah Square.	Owned
112 East Liberty Street Charles Town, WV	(4) Satellite Office Approx. 1,000 square feet	Leased
621-A South Royal Avenue Front Royal, VA	(5) Satellite Office Approx. 132 square feet	Leased
2064 Valley Road, Suite 2 Berkeley Springs, WV	(6) Satellite Office Approx. 200 square feet	Leased

(1) During 2005, the Association added approximately 1,800 square feet to expand the branch portion of the headquarters building. Additionally, a one acre unimproved lot (number 15 Kernstown Business Park) was consolidated into the present headquarters location to expand parking facilities. During 2006, the Association added approximately 11,000 square feet to expand administration offices, workroom/library facilities, provide additional rental space and add a multi-purpose conference center. Approximately 5,000 square feet of space (representing three office suites) are rented. 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. One office suite is rented to a chiropractic physician.

The New Century Realty lease is for a period of five years commencing on May 1, 2006 and ending on April 30, 2011.

The Farm Bureau lease is for a period of five years commencing on June 1, 2006 and ending on May 31, 2011.

The Chiropractic Physician lease is for a period of three years commencing on January 1, 2007 and ending on December 31, 2009.

(2) The Branch moved to a new office building in January 2006. The new office building was built on previously purchased unimproved lots numbered 2, 3 and 6 in the Ridgefield Business Park. Unimproved lots numbered 1 and 4 in the Ridgefield Business Park were previously purchased as part of a total package when the new site for the branch office was acquired. These lots were sold in August 2006.

Approximately 1,800 square feet (one office suite) is leased to MARMAR, LLC (Real Living Realty). The MARMAR, LLC (Real Living Realty) lease is for a period of three years commencing on April 1, 2006 and ending on March 31, 2009.

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

(4) The Association has leased office space to enhance the Secondary Mortgage Market presence. The lease is effective January 1, 2005 through December 31, 2017.

(5) The Association has leased office space to enhance the Secondary Mortgage Market presence. The lease (continuous from year to year) is effective June 1, 2007 through May 31, 2008.

(6) The Association has leased office space to enhance the Secondary Mortgage Market presence. The lease (continuous from year to year) is effective October 1, 2007 through September 30, 2008.

Legal Proceedings

Information, if any, to be disclosed in this section is incorporated herein by reference to Note 12 of the Consolidated Financial Statements, "Commitments and Contingencies," included in this Annual Report.

Description of Capital Structure

Information to be disclosed in this section is incorporated herein by reference to Note 7 of the Consolidated Financial Statements, "Members' Equity," included in this Annual Report.

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, 6, 10 and 12 of the Consolidated Financial Statements included in this Annual Report.

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 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 and their business experience for the past five years:

<u>Senior Officer</u>	<u>Position</u>
Robert N. Carpenter	<i>President & Chief Executive Officer</i> since August 1976
Luther O. Stiles	<i>Executive Vice President and Chief Administrative Officer</i> since October 2003; had previously served as Executive Vice President – Chief Financial Officer since January 1998, and Vice President – Finance since December 1985
Scott K. Swaim	<i>Senior Vice President – Credit</i> since January 2002, and had previously served as Vice President – Credit since January 1998
Allan K. George	<i>Senior Vice President – Lending Programs</i> since January 2002, and had previously served as Vice President – Lending Programs since January 1998
Jeffrey B. Michael	<i>Senior Vice President – Residential Lending</i> since January 2004
Stephen T. Grant	<i>Vice President – Member Services</i> since January 1998
Mary S. Miller	<i>Vice President – Chief Financial Officer</i> since October 2003
Ruth C. M. Boden	<i>Vice President – Branch Manager</i> since January 2004
Cheryl G. Keesecker	<i>Vice President – Branch Manager</i> since December 2004

The business experience for the past five years for all senior officers is with the Farm Credit System.

The total amount of compensation earned by the CEO and all senior officers as a group during the years ended December 31, 2007, 2006 and 2005, is as follows:

Name of Individual or Number in Group	Year	Annual		Deferred Comp.	Perq./ Other**	Total
		Salary	Bonus*			
Robert N. Carpenter	2007	\$192,408	–	–	\$8,250	\$200,658
Robert N. Carpenter	2006	\$185,007	–	–	\$6,332	\$191,339
8	2007	\$713,423	–	–	\$6,661	\$720,084
8	2006	\$683,564	–	–	\$6,591	\$690,155
9	2005	\$800,037	\$56,000	–	–	\$856,037

Note: Beginning with year-end 2006, CEO compensation must be disclosed as a separate line item and is not included in the aggregate amount. The CEO salary is included in the aggregate amount for 2005.

Regulatory reporting changes have affected the content of the compensation reported for 2007 and 2006 and those changes may not be reflected in the 2005 amounts.

* Bonus: In addition to a base salary, all full-time employees (or regular part-time exceeding 500 hours per year) on or before November 1st, may be eligible to earn additional compensation under an incentive plan. The amount of compensation is set and approved by the Board of Directors. The Association incentive plan is designed to motivate employees to exceed the business plan goals during the fiscal year. These goals may typically include return on assets, credit quality, credit administration, loan volume, non-accrual loan volume, permanent capital and other key ratios.

There will be no payment of an incentive on 2007 and 2006 performance. Incentives are shown in the year earned, which may be different than the year of payment. Continuation of the program is dependent on annual approval of the Board of Directors.

** Perquisites/Other include automobile compensation benefit, spousal travel and excess group life insurance if value by individual exceeds \$5,000.

Disclosure of information on the total compensation paid during 2007 to any senior officer, or to any other individual included in the total, is available to shareholders upon written request. Additionally, all employees are reimbursed for all direct travel expenses incurred when traveling on Association business. A copy of the travel policy is available to shareholders upon written request.

Directors

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 2007 honorariums:

<u>Description</u>	<u>Honorarium</u>
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 \$56,425. A majority of the Board attended a Farm Credit Council Conference for three days in 2007. The honorariums were waived. No director received more than \$5,000 in non-cash compensation during the year.

The following chart details the year the director began serving on the board, the current term of expiration, and total cash compensation paid:

<u>DIRECTOR</u>	<u>ORIGINAL YEAR OF ELECTION OR APPOINTMENT</u>	<u>CURRENT TERM EXPIRATION</u>	<u>TOTAL COMP. PAID DURING 2007</u>
Charles W. Kackley, <i>Chairman</i>	1971	2008	\$ 9,125
John P. Burns, Jr., <i>Vice Chairman</i>	1987	2009	7,225
Gary W. Bushong	1992	2010	6,700
T. Jeffery Jennings	1989	2010	6,275
Harry M. Kable	2000	2008	6,225
Jim A. Long	2000	2009	7,025
Charles W. Orndoff, Sr.	1989	2009	7,300
Betty H. Carroll, <i>Outside Director</i>	2003	2009	6,550
			<u>\$ 56,425</u>

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 farmer and owner of a lawn care business. Mr. Kackley serves on the Boards of the Clarke County Zoning Appeals (Chairman), Clarke County Fair (Vice Chairman), Clarke County Education Foundation, and Greenhill Cemetery, Berryville, Virginia. Mr. Kackley is a member of the Clarke County Ruritan Club and Berryville Baptist Church (past deacon), Berryville, Virginia.

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 and Potomac Bank Shares and Southern States Cooperative, Charles Town, West Virginia, and Jefferson County

Fair (Director 45 years; Past 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.

Gary W. Bushong retired from dairy farming in April 2007 and is now raising heifers and beef cattle. He is a member of the Rockingham Cooperative Farm Bureau (past director), Harrisonburg, Virginia; Broadway-Timberville Young Farmers, Broadway, Virginia; Rader Lutheran Church, Timberville, Virginia and National Young Farmers Association.

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. In 2004, Mr. Jennings was one of five winners of the Virginia Poultry Federation's Environmental Stewardship Award.

Harry M. (Marty) Kable is a crop farmer, auctioneer and land developer. Mr. Kable is a member of the Harpers Ferry Cooking Club, (Past President), Harpers Ferry, West Virginia; 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.

Jim A. Long is a beef and poultry farmer and wholesale nursery owner / operator. He is a director on the Boards of the Shenandoah Memorial Hospital (Vice Chairman), Woodstock, Virginia and Valley Health Systems, Winchester, Virginia.

Charles W. Orndoff, Sr. is a beef cattle farmer. He serves as President on the Board of the Farmer's Livestock Exchange, Incorporated, Winchester, Virginia and is a director on the board of 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.

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, Endowment Committee and Finance 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.

The following chart details the number of meetings, committee assignments, other activities and additional compensation paid for other activities (if applicable) for each director:

Name of Director	Days Served		Committee Assignments (Committee Comp. Paid)	Compensation Paid for other Activities*
	Regular Board Meetings	Other Official Activities*		
Charles W. Kackley, <i>Chairman</i>	9	19	Executive (\$0) Audit (\$800) Compensation (\$0)	\$ 6,425
John P. Burns, Jr., <i>Vice Chairman</i>	9	13	Executive (\$0) Audit (\$800) Compensation (\$0)	4,525
Gary W. Bushong	9	10	Building (\$0) Governance (\$275)	4,000
T. Jeffery Jennings	8	12	Credit Review (\$0) Compensation (\$0)	3,875
Harry M. Kable	7	11	Credit Review (\$0) Building (\$0) Governance (\$75)	4,125
Jim A. Long	8	12	Credit Review (\$0) Building (\$0) Governance (\$200)	4,625
Charles W. Orndoff, Sr.	9	12	Audit (\$800) Credit Review (\$0) Building (\$0) Governance (\$275)	4,600
Betty H. Carroll, <i>Outside Director</i>	9	12	Audit (\$800) Compensation (\$0)	4,450
				\$ 36,625

* Includes board committee meetings and other board activities other than regular board meetings, including annual retainer, training meetings, and conference calls.

Directors 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 \$66,025 for 2007, \$37,335 for 2006, and \$47,379 for 2005.

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 11 of the Consolidated Financial Statements, "Related Party Transactions," included in this Annual Report. There have been no transactions between the Association and senior officers or directors which require reporting per FCA regulations.

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. No directors or senior officers have been involved in any legal proceedings during the last five years which require reporting per FCA regulations.

Relationship with Independent Auditors and Other Qualified Public Accountants

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

Aggregate fees incurred by the Association for services rendered by its independent auditors for the year ended December 31, 2007 were as follows:

	<u>2007</u>
<i>Independent Auditor</i>	
PricewaterhouseCoopers LLP	
Audit services	<u>\$ 46,824</u>

Audit fees were for the annual audit of the consolidated financial statements.

The independent auditor did not perform any non-audit services for the Association during the year ended December 31, 2007.

Consolidated Financial Statements

The consolidated financial statements, together with the report thereon of PricewaterhouseCoopers LLP dated February 28, 2008 and the report of management, which appear in this Annual Report are incorporated herein by reference.

Copies of the Association’s Annual and 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, PO Box 2700, Winchester, VA 22604 or accessing the website, *www.valleyfc.com*. The Association prepares an electronic version of the Annual Report which is available on the Association’s web site within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Association prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

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. 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.

Credit and Services to Young, Beginning, and Small Farmers and Ranchers and Producers or Harvesters of Aquatic Products

Information to be disclosed in this section is incorporated herein by reference to the similarly named section in the Management’s Discussion and Analysis of Financial Condition and Results of Operations section included in this annual report to the shareholders.

Shareholder Investment

Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank (Bank or AgFirst). Copies of the Bank’s Annual and Quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 378, or writing Stephen Gilbert, 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 web site at *www.agfirst.com*. The Bank prepares an electronic version of the Annual Report, which is available on the website, within 75 days after the end of the fiscal year and distributes the Annual Reports to shareholders within 90 days after the end of the fiscal year. The Bank prepares an electronic version of the Quarterly report within 40 days after the end of each fiscal quarter, except that no report needs to be prepared for the fiscal quarter that coincides with the end of the fiscal year of the Bank.

Report of the Audit Committee

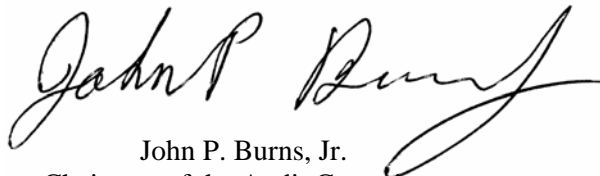
The Audit Committee of the Board of Directors (Committee) is comprised of the directors named below. None of the directors who serve on the Committee is an employee of Valley Farm Credit, ACA (Association) and in the opinion of the Board of Directors, each is free of any relationship with the Association 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 2007, is responsible for expressing an opinion on the conformity of the Association's audited financial statements with accounting principles generally accepted in the United States of America. The Committee has discussed with PwC the matters that are required to be discussed by Statement on Auditing Standards No. 114 (*The Auditor's Communication With Those Charged With Governance*). 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 2007. The foregoing report is provided by the following independent directors, who constitute the Committee:



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

Members of Audit Committee

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

February 28, 2008

Report of Independent Auditors



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

Report of Independent Auditors

To the Board of Directors and Members
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 (the Association) and its subsidiaries at December 31, 2007, 2006 and 2005, and the results of their operations and their cash flows for the years then ended 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

February 28, 2008

Notes to the Consolidated Financial Statements

(dollars in thousands, except as noted)

Note 1 — Organization and Operations

A. **Organization:** Valley Farm Credit, ACA (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 (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 (Farm Credit Act). The most recent significant amendment to the Farm Credit Act was the Agricultural Credit Act of 1987. At December 31, 2007, the System was comprised of four Farm Credit Banks, one Agricultural Credit Bank and ninety-four Associations.

AgFirst Farm Credit Bank (Bank) and its related Associations are collectively referred to as the "District." The Bank provides funding to associations within the District and is responsible for supervising certain activities of the Association, as well as the other Associations operating within the District. The District consists of the Bank and twenty-three Agricultural Credit Associations (ACAs), all of which are structured as ACA parent-companies, which have two wholly owned subsidiaries, a Federal Land Credit Association (FLCA) and a Production Credit Association (PCA). FLCAs are tax-exempt while ACAs and PCAs are taxable.

ACA parent-companies provide financing and related services through its FLCA and PCA subsidiaries. The FLCA makes collateralized 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 FCA examines the activities of the associations 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 to provide assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation. Each System bank is required to pay premiums, which may be passed on to the Association, into the Insurance Fund, based on its annual average loan principal outstanding until the monies in the Insurance Fund reach the "secure base amount." The secure base amount is defined in the Farm Credit Act as 2.0 percent of the aggregate insured obligations (Systemwide debt obligations) or such other percentage of the aggregate obligations as the Insurance Corporation in its sole discretion determines to be actuarially sound. 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 System 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.

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 the current year's 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 statements 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 original maturities ranging from 5 to 40 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 daily principal amount outstanding.

Loans are generally placed in nonaccrual status when principal or interest is delinquent for 90 days (unless adequately collateralized 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 the prior year).

When loans are in nonaccrual status, the interest portion of payments received in cash is 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. Nonaccrual loans may be returned 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."

Loans are charged-off, wholly or partially, as appropriate, at the time they are determined to be uncollectible.

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 interest income using the effective interest method.

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 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.

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loan. Impaired loans include nonaccrual loans, restructured loans, loans assigned a specific reserve, and loans past due 90 days or more and still accruing interest. A loan is considered contractually past due when any principal repayment or interest payment required by the loan instrument is not received on or before the due date. A loan shall remain contractually past due until it is formally restructured or until the entire amount past due, including principal, accrued interest, and penalty interest incurred as the result of past due status, is collected or otherwise discharged in full.

A specific allowance may be established for impaired loans under Statement of Financial Accounting Standards 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.

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 allowance reversals and loan charge-offs.

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. Gains or losses on sales of these 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 classified as due from AgFirst Farm Credit Bank.
- E. Other Property Owned:** Other property owned, consisting of real and personal property acquired through a collection action, is recorded upon acquisition at fair value less estimated selling costs. 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, expenses, and carrying value adjustments related to other property owned are included in gains (losses) on other property owned, net. The Association did not have any other property owned during 2007, 2006 or 2005.
- F. Premises and Equipment:** Premises and equipment are carried at cost less accumulated depreciation. Land is carried at cost. 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 earnings. Maintenance and repairs are charged to 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 Consolidated Balance Sheets. Advanced conditional payments are not insured. Interest is generally paid by the Association on such accounts. The Association did not have any advanced conditional payments during 2007, 2006 or 2005.
- H. Employee Benefit Plans:** Substantially all employees of the Association may participate in the AgFirst Farm Credit Retirement Plan (Plan), which is a defined benefit plan and is considered a multi-employer plan. The Plan is noncontributory and includes eligible District employees. The "Projected Unit Credit" actuarial method is used for financial reporting purposes. 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 cost of the Plan is allocated based on a percentage of each institution's salary expense to the total salary expense for all Plan participants.

Substantially all 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 contributes \$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 expensed as funded.

Effective January 1, 2006 the Districtwide 401(k) Plan known as the AgFirst Farm Credit Employee Thrift Plan merged with the Farm Credit Bank of Texas Thrift Plus Plan. The new plan is known as the AgFirst/FCBT 401(k) Employee Benefit Plan.

The Association may provide 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.

- I. Income Taxes:** The Association is generally subject to Federal and certain other income taxes. As previously described, the ACA holding company has two wholly-owned subsidiaries, a PCA and a FLCA. The FLCA subsidiary is exempt from federal and state income taxes as provided in the Farm Credit Act. The ACA holding company and the PCA subsidiary are subject to federal, state 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 accounts for income taxes under the asset and liability method, recognizing 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.

The Association records a valuation allowance at the balance sheet dates against that portion of the Association's deferred tax assets that, based on management's best estimates of future events and circumstances, more likely than not (a likelihood of more than 50 percent) will not be realized. The consideration of valuation allowances involves various estimates and assumptions as to future taxable earnings, including the effects of our expected patronage program, which reduces taxable earnings.

- J. Patronage Refund from AgFirst:** The Association records patronage refunds from the Bank on an accrual basis.
- K. Recently Issued Accounting Pronouncements:** In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109*" (FIN 48 or Interpretation) that was effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies how an enterprise should recognize, measure, present and disclose in its financial statements uncertain tax positions that the enterprise has taken or expects to take on a tax return. Under the Interpretation, the financial statements reflect expected future tax

consequences of income tax positions presuming the relevant taxing authority's full knowledge of the position and all relevant facts, but without considering time values. FIN 48 is applicable to all uncertain positions for taxes accounted for under FASB Statement No. 109. The Association adopted FIN 48 on January 1, 2007 and determined that interest and penalties would be classified as a component of income taxes.

There were no uncertain positions for income taxes at January 1, 2007 identified as a result of the adoption and therefore no cumulative adjustment to beginning members' equity was required. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." The Standard requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through other comprehensive income. The Standard further requires the determination of the fair value of plan assets at year-end and recognition of actuarial gains and losses, prior service costs or credits, and transition assets and obligations as a component of other comprehensive income. In addition, this Standard requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the District uses a measurement date of September 30th. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. See Note 9, "Employee Benefit Plans," of the Notes to the Consolidated Financial Statements, for the impact of the adoption of FAS 158 on the current period.

In September 2006, the FASB also issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements." This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. As a result, there is now a common definition of fair value to be used throughout generally accepted accounting principles. The FASB believes that the new standard will make the measurement of fair value more consistent and comparable and improve disclosures about those measures. This Statement clarifies that the term fair value is intended to mean a market-based measure, not an entity-specific measure. In measuring fair value for a financial statement item, the Statement sets forth a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The highest priority is given to quoted prices in active markets and the lowest priority to unobservable inputs. Additional disclosure requirements will be required for the lowest priority level. The Statement became effective as of January 1, 2008, and will be applied to the Association's Consolidated Financial Statements on a prospective basis.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "Fair Value Option for Financial Assets and Financial Liabilities." The Standard permits entities to choose on an instrument-by-instrument basis, at specified election dates, to measure financial assets and liabilities and certain other items at fair value (the "fair value option"). Unrealized gains and losses on items for which the fair value option has been elected must be reported in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. This Standard became effective as of January 1, 2008. The Association has not made any elections under the fair value option, thus there will be no impact of the initial adoption of the Standard. However, the Association may elect to apply the fair value option to financial instruments acquired in future periods.

Note 3 — Loans and Allowance for Loan Losses

A summary of loans follows:

	December 31,		
	2007	2006	2005
Real estate mortgage	\$ 81,305	\$ 72,897	\$ 78,434
Production and intermediate term	73,730	77,433	62,628
Processing and marketing	2,101	1,805	2,230
Farm related business	1,093	1,801	1,901
Rural residential real estate	16,361	18,907	16,995
Total loans	<u>\$ 174,590</u>	<u>\$ 172,843</u>	<u>\$ 162,188</u>

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, 2007, 2006 and 2005 consisted of the following commodity types:

Commodity Type	December 31,		
	2007	2006	2005
Part-time and Other	36%	36%	33%
Livestock	27	25	25
Poultry	16	17	20
Rural Home	9	10	9
Orchard	7	7	7
Dairy	5	5	6
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>

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 collateralized 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,		
	2007	2006	2005
Nonaccrual loans:			
Current as to principal and interest	\$ 35	\$ -	\$ -
Past due	-	-	-
Total nonaccrual loans	<u>35</u>	<u>-</u>	<u>-</u>
Impaired accrual loans:			
Restructured accrual loans	-	-	-
Accrual loans 90 days or more past due	752	-	-
Accrual loans less than 90 days past due	34	-	-
Total impaired accrual loans	<u>786</u>	<u>-</u>	<u>-</u>
Total impaired loans	<u>\$ 821</u>	<u>\$ -</u>	<u>\$ -</u>

There were no material commitments to lend additional funds to debtors whose loans were classified as impaired at December 31, 2007.

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,		
	2007	2006	2005
Interest income recognized on nonaccrual loans	\$ -	\$ -	\$ -
Interest income on impaired accrual loans	<u>15</u>	<u>1</u>	<u>7</u>
Interest income recognized on impaired loans	<u>\$ 15</u>	<u>\$ 1</u>	<u>\$ 7</u>

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

	2007	2006	2005
Impaired loans with related allowance	\$ 34	\$ -	\$ -
Impaired loans with no related allowance	787	-	-
Total impaired loans	<u>\$ 821</u>	<u>\$ -</u>	<u>\$ -</u>
Allowance on impaired loans	<u>\$ 21</u>	<u>\$ -</u>	<u>\$ -</u>

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

	2007	2006	2005
Average impaired loans	<u>\$ 236</u>	<u>\$ 12</u>	<u>\$ 92</u>

The following table summarizes interest income on nonaccrual and accruing restructured loans that would have been recognized under the original terms of the loans:

	Year Ended December 31,		
	2007	2006	2005
Interest income which would have been recognized under the original loan terms	\$ 6	\$ -	\$ -
Less: interest income recognized	-	-	-
Foregone interest income	<u>\$ 6</u>	<u>\$ -</u>	<u>\$ -</u>

The changes in the allowance for loan losses are as follows:

	Year Ended December 31,		
	2007	2006	2005
Balance at beginning of year	\$ 594	\$ 710	\$ 828
Charge-offs:			
Real estate mortgage	(15)	-	-
Production and intermediate term	-	-	(2)
Total charge-offs	<u>(15)</u>	<u>-</u>	<u>(2)</u>
Recoveries:			
Production and intermediate term	-	-	2
Total recoveries	<u>-</u>	<u>-</u>	<u>2</u>
Net (charge-offs) recoveries	<u>(15)</u>	<u>-</u>	<u>-</u>
Provision for (reversal of allowance for) loan losses	<u>(25)</u>	<u>(116)</u>	<u>(118)</u>
Balance at end of year	<u>\$ 554</u>	<u>\$ 594</u>	<u>\$ 710</u>

Ratio of net (charge-offs) recoveries during the period to average loans outstanding during the period

	2007	2006	2005
	(0.009)%	-%	-%

In addition, the following is a breakdown of the allowance for loan losses for the end of the last three fiscal years:

	December 31, 2007		December 31, 2006	
	Amount	%	Amount	%
Real estate mortgage	\$ 195	35%	\$ 188	32%
Production and intermediate term	299	54	329	55
Agribusiness	8	2	12	2
Rural residential real estate	52	9	65	11
Total	<u>\$ 554</u>	<u>100%</u>	<u>\$ 594</u>	<u>100%</u>

	December 31, 2005	
	Amount	%
Real estate mortgage	\$ 257	36%
Production and intermediate term	361	51
Agribusiness	18	3
Rural residential real estate	74	10
Total	<u>\$ 710</u>	<u>100%</u>

To mitigate the risk of loan losses, the Association may enter into long-term standby “commitment to purchase” agreements with the Federal Agricultural Mortgage Corporation (Farmer Mac). 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 (typically four months past due), subject to certain conditions. The balance of loans under long-term standby commitments was \$6,818, \$8,749 and \$9,691 at December 31, 2007, 2006 and 2005, respectively. Fees paid to Farmer Mac for such commitments totaled \$42, \$49 and \$59 for the years ended December 31, 2007, 2006 and 2005, respectively. These amounts are classified as noninterest expense.

Note 4 — 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 5 — Premises and Equipment

Premises and equipment consisted of the following:

	December 31,		
	2007	2006	2005
Land	\$ 1,164	\$ 1,164	\$ 1,130
Buildings and improvements	6,982	7,015	5,448
Furniture and equipment	2,194	2,114	1,905
	10,340	10,293	8,483
Less: accumulated depreciation	2,265	1,862	1,550
Total	<u>\$ 8,075</u>	<u>\$ 8,431</u>	<u>\$ 6,933</u>

Note 6 — 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 5.81 percent for LIBOR-based loans, 5.74 percent for Prime-based loans, and the weighted average remaining maturities were 3.9 years and 2.2 years, respectively, at December 31, 2007. The weighted average interest rate on the fixed rate and adjustable rate mortgage (ARM) notes payable which are match funded by the Bank was 5.68 percent and the weighted average remaining maturity was 8.2 years at December 31, 2007. The weighted average interest rate on all interest-bearing notes payable was 5.70 percent and the weighted average remaining maturity was 7.3 years at December 31, 2007.

Variable rate and fixed rate notes payable represent approximately 8.84 percent and 91.16 percent, respectively, of total notes payable at December 31, 2007.

Under the Farm Credit Act, the Association is obligated to borrow only from the Bank, unless the Bank approves borrowing from other funding sources. 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, 2007, the Association’s notes payable were within the specified limitations.

Note 7 – 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 thousand), 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

The 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 the 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. The 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, 2007 were 13.68 percent, 11.17 percent and 10.53 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, 2007:

Class	Protected	Shares Outstanding	
		Number	Aggregate Par Value
A Preferred/Nonvoting	No	113,958	\$ 570
C Common/Voting	No	594,649	2,973
C Participation Certificates/Nonvoting	No	80,353	402
Total Capital Stock and Participation Certificates		788,960	\$ 3,945

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, 2007, allocated members' equity consisted of \$684 of qualified surplus and \$3,803 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 its subsidiaries for such fiscal year or for that and subsequent fiscal years. Patronage distributions are based on the proportion of the borrower's interest to the amount of interest earned by the Association on its total loans unless another proportionate patronage basis is approved by the Board.

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 or 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.

Note 8 — Income Taxes

The provision (benefit) for income taxes follows:

	Year Ended December 31,		
	2007	2006	2005
Current:			
Federal	\$ 12	\$ (2)	\$ 3
State	(47)	—	1
	<u>(35)</u>	<u>(2)</u>	<u>4</u>
Deferred:			
Federal	—	—	—
State	—	—	—
	<u>—</u>	<u>—</u>	<u>—</u>
Total provision (benefit) for income taxes	<u>\$ (35)</u>	<u>\$ (2)</u>	<u>\$ 4</u>

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,		
	2007	2006	2005
Federal tax at statutory rate	\$ 635	\$ 646	\$ 878
State tax, net	(31)	—	—
Patronage distributions	(65)	(34)	(36)
Tax-exempt FLCA earnings	(276)	(225)	(838)
Change in deferred tax asset valuation allowance	(536)	(448)	40
Other	238	59	(40)
Provision (benefit) for income taxes	<u>\$ (35)</u>	<u>\$ (2)</u>	<u>\$ 4</u>

Deferred tax assets and liabilities result from the following at:

	December 31,		
	2007	2006	2005
Deferred income tax assets:			
Allowance for loan losses	\$ 97	\$ 112	\$ 124
Net operating loss – carryforward	255	761	1,073
Nonaccrual loan interest	2	—	—
Gross deferred tax assets	<u>354</u>	<u>873</u>	<u>1,203</u>
Less: valuation allowance	(59)	(595)	(1,043)
Gross deferred tax assets, net of valuation allowance	<u>295</u>	<u>278</u>	<u>160</u>
Deferred income tax liabilities:			
Loan fees	(295)	(278)	(160)
Gross deferred tax liability	<u>(295)</u>	<u>(278)</u>	<u>(160)</u>
Net deferred tax asset (liability)	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

At December 31, 2007, deferred income taxes have not been provided by the Association on approximately \$1.4 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.

The Association recorded a valuation allowance of \$59, \$595 and \$1,043 during 2007, 2006 and 2005, respectively. The Association will continue to evaluate the realizability of these deferred tax assets and adjust the valuation allowance accordingly.

The Association adopted the provisions of the Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," on January 1, 2007. As a result of the adoption, there were no uncertain positions for income taxes identified and therefore the Association recognized no change in the liability for unrecognized tax benefits and no reduction to the January 1, 2007 balance of retained earnings. The Association recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense. There were no uncertain tax positions identified related to the current year. The tax years that remain open for federal and major state income tax jurisdictions are 2004 and forward.

Note 9 — Employee Benefit Plans

The employees of the Association may participate 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. As a participant in the District's defined benefit plan, the Association funded \$0 for 2007 and 2006, and \$610 for 2005, through its note payable to the Bank. Plan expenses included in salaries and employee benefits were \$356 for 2007, \$448 for 2006, and \$398 for 2005. Additional financial information for the Plan may be found in the District's Annual Report.

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. Employee deferrals are not to exceed the maximum deferral as adjusted by the Internal Revenue Service. Employer contributions to this plan were \$135, \$138, and \$126 for the years ended December 31, 2007, 2006 and 2005, respectively.

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. Postretirement benefits other than pensions (primarily health care benefits) included in salaries and employee benefits were \$122 for 2007, \$129 for 2006 and \$176 for 2005. The adoption of FAS 158 and the corresponding impact was recorded at a District level only and not reflected directly in the Association's Consolidated Financial Statements. Additional financial information for the Plan may be found in the Notes to the Combined Financial Statements of AgFirst Farm Credit Bank and District Associations' 2007 Annual Report.

Note 10 — Intra-System Financial Assistance

The Farm Credit Act provided for capital assistance to System institutions experiencing severe financial stress through the issuance, prior to October 1, 1992, by the Financial Assistance Corporation of U.S. Treasury-guaranteed 15-year bonds, of which \$1.261 billion in principal amount was originally issued. The last remaining Financial Assistance Corporation bonds matured and were repaid on June 10, 2005.

Pursuant to the Farm Credit Act, the U.S. Treasury paid \$440 million, on behalf of the System, in interest costs on \$844 million of the Financial Assistance Corporation bonds issued for purposes other than funding Capital Preservation Agreement accruals. The Banks had irrevocably set aside funds, including interest earned, that totaled the \$440 million needed to repay the interest advanced by the U.S. Treasury. On June 10, 2005, the Banks repaid the U.S. Treasury the interest advanced. The Farm Credit Administrative Board cancelled the Financial Assistance Corporation's charter as of December 31, 2006.

Note 11 — 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, 2007 amounted to \$4,252. During 2007, \$748 of new loans were made and repayments totaled \$1,552. In the opinion of management, none of these loans outstanding at December 31, 2007 involved more than a normal risk of collectibility.

Note 12 — 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, 2007, \$33,072 of commitments to extend credit and \$0 of commercial 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 Consolidated Balance Sheets 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. At December 31, 2007, the Association had outstanding \$2,410 of standby letters of credit, with expiration dates ranging from January 31, 2008 to December 22, 2009. The maximum potential amount of future payments the Association may be required to make under these existing guarantees is \$2,410.

A guarantor is required to recognize at the inception of a guarantee, a liability for the fair value of the guarantee commitment. The Association has determined the fair value of the guarantee commitment based upon the fees to be earned over the life of the guarantee. The fair value is updated periodically to reflect changes in individual guarantee amounts and the remaining life to maturity of the individual guarantees in the Association's inventory. At December 31, 2007, the Association's inventory of standby letters of credit had a fair value of \$24 and was included in other liabilities.

Note 13 — 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, 2007, 2006 and 2005. 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, 2007		December 31, 2006	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash	\$ 243	\$ 243	\$ 1,039	\$ 1,039
Loans	\$ 174,590	\$ 176,758	\$ 172,843	\$ 173,887
Allowance for loan losses	554	—	594	—
Loans, net	\$ 174,036	\$ 176,758	\$ 172,249	\$ 173,887
Financial liabilities:				
Notes payable to AgFirst Farm Credit Bank	\$ 161,298	\$ 162,034	\$ 161,731	\$ 160,039

	December 31, 2005	
	Carrying Amount	Estimated Fair Value
Financial assets:		
Cash	\$ 602	\$ 602
Loans	\$ 162,188	\$ 161,073
Allowance for loan losses	710	—
Loans, net	\$ 161,478	\$ 161,073
Financial liabilities:		
Notes payable to AgFirst Farm Credit Bank	\$ 149,339	\$ 145,895

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 4, the net investment is a requirement of borrowing from the Bank and is carried at cost plus allocated equities in the accompanying Consolidated Balance Sheets. The Association owns 1.26 percent of the issued stock of the Bank as of December 31, 2007 net of any reciprocal investment. As of that date, the Bank's assets totaled \$26.9 billion and shareholders' equity totaled \$1,457 million. The Bank's earnings were \$192 million during 2007.
- 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 14 — Quarterly Financial Information (Unaudited)

Quarterly results of operations for the years ended December 31, 2007, 2006 and 2005 follow:

	2007				
	First	Second	Third	Fourth	Total
Net interest income	\$ 1,122	\$ 1,062	\$ 1,032	\$ 1,028	\$ 4,244
Provision for (reversal of allowance for) loan losses	—	—	(24)	(1)	(25)
Noninterest income (expense), net	(706)	(635)	(760)	(264)	(2,365)
Net income (loss)	\$ 416	\$ 427	\$ 296	\$ 765	\$ 1,904

	2006				
	First	Second	Third	Fourth	Total
Net interest income	\$ 979	\$ 987	\$ 1,057	\$ 1,100	\$ 4,123
Provision for (reversal of allowance for) loan losses	(13)	(28)	(75)	—	(116)
Noninterest income (expense), net	(926)	(715)	(425)	(270)	(2,336)
Net income (loss)	\$ 66	\$ 300	\$ 707	\$ 830	\$ 1,903

	2005				
	First	Second	Third	Fourth	Total
Net interest income	\$ 962	\$ 982	\$ 1,017	\$ 996	\$ 3,957
Provision for (reversal of allowance for) loan losses	—	—	—	(118)	(118)
Noninterest income (expense), net	(682)	(33)	(608)	(173)	(1,496)
Net income (loss)	\$ 280	\$ 949	\$ 409	\$ 941	\$ 2,579