

---

*Farm Credit of the Virginias, ACA*  
***THIRD QUARTER 2002***

Management's Discussion and Analysis of  
Financial Condition and Results of Operations .....2

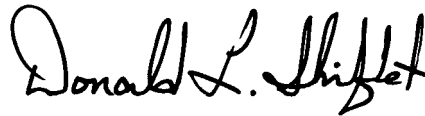
Consolidated Financial Statements

Consolidated Balance Sheets .....4

Consolidated Statements of Income.....5

Consolidated Statements of Changes in Members' Equity .....6

Notes to the Consolidated Financial Statements.....7



Donald L. Shiflet  
Chief Executive Officer



Paul House  
Chairman of the Board

October 29, 2002

---

## *Farm Credit of the Virginias, ACA*

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

*(dollars in thousands)*

The following commentary reviews the consolidated financial condition and results of operations of Farm Credit of the Virginias, ACA (Association) for the period ended September 30, 2002. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2001 Annual Report of 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. The Association's loan portfolio is diversified over a range of agricultural commodities in our region, including livestock, poultry and field crops. Farm size varies and many of the borrowers in the region have diversified farming operations. This factor, along with the numerous opportunities for non-farm income in the area, somewhat impacts the level of dependency on a given commodity.

The gross loan volume of the Association as of September 30, 2002, was \$995,063, an increase of \$92,508 as compared to \$902,555 at December 31, 2001. During the past nine months, loan volume has increased primarily due to the continued strong demand in loans. With interest rates continuing to fall during 2002, the demand for loans has continued at a strong pace. Net loans outstanding at September 30, 2002, were \$971,163 as compared to \$880,455 at December 31, 2001. Net loans were 96.30 percent of total assets at September 30, 2002.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level, however, and credit administration remains satisfactory. Nonaccrual loans increased from \$1,933 at December 31, 2001, to \$2,899 at September 30, 2002. This increase was primarily the result of several loans being downgraded to nonaccrual status.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The Association increased the

allowance for loan losses during the nine months ended September 30, 2002 by \$1,800. The addition was mainly due to an increase in portfolio risk as the economy continued to show some weakness and an increase in loan volume. The allowance for loan losses at September 30, 2002, was \$23,900 compared to \$22,100 at December 31, 2001, and was considered by management to be adequate to cover possible losses.

### **RESULTS OF OPERATIONS**

#### *For the three months ended September 30, 2002*

Net income for the three months ended September 30, 2002, totaled \$3,554, as compared to \$5,102 for the same period in 2001, a decrease of \$1,548. The decrease in net income for the third quarter 2002, was primarily due to the recognition last year of the refund of federal income tax and interest on the refund as a result of the IRS tax settlement.

Net interest income increased \$188, for the three months ended September 30, 2002, as compared to the same period in 2001. The increase in net interest income was mainly due to increased loan volume as compared to the same period last year. The Association's accruing loan volume has increased 16 percent when compared to the third quarter of 2001.

Noninterest income for the three months ended September 30, 2002, totaled \$1,911, as compared to \$1,796 for the same period of 2001, an increase of \$115. The increase was primarily due to an increase in loan fees and equity in earnings of AgFirst Farm Credit Bank (the Bank).

Noninterest expense for the three months ended September 30, 2002 totaled \$3,081. This was an increase of \$542 compared to the same period of 2001. The primary reason for the increase was higher salaries and employee benefits expense and insurance fund premiums.

The Association recognized a provision for income taxes for the three months ended September 30, 2002 totaling \$373, as compared to a tax benefit of \$835 during the same period last year. Last year's income tax benefit was primarily due to the refund of federal income taxes from the IRS tax settlement.

---

### ***For the nine months ended September 30, 2002***

Net income for the nine months ended September 30, 2002, totaled \$9,880, as compared to \$14,395 for the same period in 2001, a decrease of \$4,515. The decrease was mainly due to:

- a decrease in net interest income
- an increase in the provision of loan losses, and
- the recognition in 2001 of the tax refund and interest on the refund from the IRS tax settlement.

Net interest income decreased \$1,740, for the nine months ended September 30, 2002, as compared to the same period in 2001. The decrease in net interest income was due primarily to the historical low interest rates in 2002 that resulted in reducing the Association's earnings on its lendable capital as compared to the first nine months last year. Also, during the first nine months of 2001, the Association recognized \$400 in interest on loans that were in nonaccrual status compared to \$69 during the same period this year.

The Association recorded a provision for loan losses of \$1,824 for the nine months ended September 30, 2002, compared to a provision of \$1,138 for the same period last year, an increase of \$686.

Noninterest income for the nine months ended September 30, 2002, totaled \$5,403, as compared to \$6,123 for the same period of 2001, a decrease of \$720. The decrease was due primarily to a decrease in miscellaneous income of \$1,457. The decrease in miscellaneous income was due to recognition last year of the interest income on the refund of federal income tax from IRS tax settlement.

Noninterest expense for the nine months ended September 30, 2002, decreased \$2,109 compared to the same period of 2001. The primary reason for the decrease was the merger-related expenses of \$3,571 recorded in 2001. There were no merger-related expenses recorded during the period for 2002. Without the merger-related expenses, noninterest expense increased \$1,462. The increase was mainly due to increases in salaries and employee benefits and insurance fund premium.

The Association recognized a provision for income taxes for the nine months ended September 30, 2002 totaling \$383, as compared to a tax benefit of \$3,095 during the same period last year. Last year's tax benefit was due to the accrual of the refund on federal income taxes from the IRS tax settlement.

### **FUNDING SOURCES**

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal

performance as criteria for establishing a line of credit on which the Association may draw funds. The Bank advances the funds to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at September 30, 2002, was \$827,487 as compared to \$737,512 at December 31, 2001. The increase during the period is primarily attributed to the increase in loan volume.

### **CAPITAL RESOURCES**

Total members' equity at September 30, 2002 totaled \$167,394, an increase of \$10,724, as compared to \$156,670 at December 31, 2001. The increase in members' equity was primarily attributed to earnings.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus and core surplus as defined in FCA regulations, by a risk-adjusted asset base. As of September 30, 2002, the Association's permanent capital ratio was 15.48 percent, total surplus ratio was 13.27 percent and core surplus ratio was 10.42 percent. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

### **IRS TAX SETTLEMENT**

As previously disclosed in the 2001 Annual Report of the Association, Farm Credit System Agricultural Credit Associations (ACA) entered into a settlement process with the IRS to resolve conclusively the status of all claimed refunds and the ongoing tax status of the ACA using another ACA as a model. In August 2000, the model ACA reached a settlement agreement with the IRS, which established the collectibility of a portion of the claimed refunds of taxes previously paid, plus interest, related to income earned in prior years from the mortgage lending activities of the ACA. This agreement also confirmed that all income generated by an ACA will be taxable in future periods. However, an ACA may reorganize to operate their long-term mortgage lending activities through a newly created FLCA subsidiary and their short- and intermediate-term lending activities through a newly created PCA subsidiary. Income earned by the FLCA subsidiary is exempt from taxation. The Association reorganized in such a manner effective January 1, 2001. As a result, the Association recognized \$4,113 in tax refunds and \$1,834 of interest on those refunds in 2001.

*Farm Credit of the Virginias, ACA*  
**Consolidated Balance Sheets**

<i>(dollars in thousands)</i>	<b>September 30, 2002</b>	<b>December 31, 2001</b>
	<i>(unaudited)</i>	
<b>Assets</b>		
Cash	\$ 17	\$ 538
Loans	995,063	902,555
Less: allowance for loan losses	23,900	22,100
Net loans	971,163	880,455
Accrued interest receivable	9,505	6,386
Investment in AgFirst Farm Credit Bank	17,873	17,873
Premises and equipment, net	3,699	3,873
Deferred tax asset, net	24	13
Other assets	6,235	7,138
Total assets	<u>\$ 1,008,516</u>	<u>\$ 916,276</u>
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 827,487	\$ 737,512
Accrued interest payable	3,952	3,831
Patronage refund payable	9	9,886
Postretirement benefits other than pensions	4,058	3,771
Other liabilities	5,616	4,606
Total liabilities	<u>841,122</u>	<u>759,606</u>
Commitments and contingencies		
<b>Members' Equity</b>		
Capital stock and participation certificates	20,708	21,580
Retained earnings		
Allocated	57,060	55,329
Unallocated	89,626	79,761
Total members' equity	<u>167,394</u>	<u>156,670</u>
Total liabilities and members' equity	<u>\$ 1,008,516</u>	<u>\$ 916,276</u>

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

*Farm Credit of the Virginias, ACA*  
**Consolidated Statements of Income**  
*(unaudited)*

<i>(dollars in thousands)</i>	<b>For the three months ended September 30,</b>		<b>For the nine months ended September 30,</b>	
	<b>2002</b>	<b>2001</b>	<b>2002</b>	<b>2001</b>
<b>Interest Income</b>				
Loans	\$ 16,635	\$ 17,055	\$ 48,330	\$ 51,872
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	10,937	11,545	32,703	34,505
Net interest income	5,698	5,510	15,627	17,367
Provision for (reversal of) loan losses	601	500	1,824	1,138
Net interest income after provision for (reversal of) loan losses	5,097	5,010	13,803	16,229
<b>Noninterest Income</b>				
Loan fees	341	177	827	594
Fees for financially related services	13	20	46	59
Equity in earnings of AgFirst Farm Credit Bank	1,540	1,345	4,404	3,887
Miscellaneous	17	254	126	1,583
Total noninterest income	1,911	1,796	5,403	6,123
<b>Noninterest Expense</b>				
Salaries and employee benefits	2,055	1,645	6,105	4,997
Occupancy and equipment	244	274	696	733
Insurance Fund premium	73	—	213	—
Other operating expenses	709	620	1,929	1,751
Merger-related expenses	—	—	—	3,571
Total noninterest expense	3,081	2,539	8,943	11,052
Income before income taxes	3,927	4,267	10,263	11,300
Provision (benefit) for income taxes	373	(835)	383	(3,095)
Net income	\$ 3,554	\$ 5,102	\$ 9,880	\$ 14,395

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

*Farm Credit of the Virginias, ACA*  
**Consolidated Statements of Changes in  
Members' Equity**

*(unaudited)*

<i>(dollars in thousands)</i>	<b>Capital Stock and Participation Certificates</b>	<b><u>Retained Earnings</u></b>		<b>Total Members' Equity</b>
		<b>Allocated</b>	<b>Unallocated</b>	
Balance at December 31, 2000	\$ 23,874	\$ 55,994	\$ 76,870	\$ 156,738
Net income			14,395	14,395
Capital stock/participation certificates issued	749			749
Capital stock/participation certificates retired	(2,727)			(2,727)
Retained earnings retired		(102)		(102)
Distribution adjustment		(1)		(1)
Balance at September 30, 2001	<u>\$ 21,896</u>	<u>\$ 55,891</u>	<u>\$ 91,265</u>	<u>\$ 169,052</u>
Balance at December 31, 2001	\$ 21,580	\$ 55,329	\$ 79,761	\$ 156,670
Net income			9,880	9,880
Capital stock/participation certificates issued	925			925
Capital stock/participation certificates retired	(1,797)			(1,797)
Retained earnings retired		(76)		(76)
Distribution adjustment		1,807	(15)	1,792
Balance at September 30, 2002	<u>\$ 20,708</u>	<u>\$ 57,060</u>	<u>\$ 89,626</u>	<u>\$ 167,394</u>

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

---

*Farm Credit of the Virginias, ACA*

# Notes to the Consolidated Financial Statements

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

## **NOTE 1 — ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES**

A description of the organization and operations of Farm Credit of the Virginias, ACA (the Association), the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2001, are contained in the 2001 Annual Report to Stockholders. These unaudited third quarter 2002 consolidated financial statements should be read in conjunction with the 2001 Annual Report to Stockholders.

As disclosed in the 2001 Annual Report, pursuant to a plan of restructuring approved by the Farm Credit Administration and Association shareholders, the Association reorganized its corporate structure effective January 1, 2001. Pursuant to this restructuring, a Federal Land Credit Association (FLCA) and Production Credit Association (PCA) were formed as wholly owned subsidiaries of the Association. The formation of these subsidiaries enables the Association to take advantage of the tax-exempt status of long-term mortgage interest for loans held by the FLCA. This restructuring was accounted for as a reorganization of entities under common control similar to a pooling of interests.

Prior to the restructuring, the Association was subject to federal and state income tax. As a result of the restructuring, long-term lending activity has been separated into a wholly owned FLCA subsidiary which is exempt from federal and state income tax. The ACA, which is the holding company, along with the wholly owned PCA subsidiary, will continue to be subject to income tax.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles. The results for the nine months ended September 30, 2002, are not necessarily indicative of the results to be expected for the year ending December 31, 2002.

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

The Association maintains an allowance for loan losses in accordance with generally accepted accounting principles. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of September 30, 2002, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

## **NOTE 2 — ALLOWANCE FOR LOAN LOSSES**

An analysis of the allowance for loan losses follows:

Balance at 12-31-00	\$20,400
(Reversal of) provision for loan losses	1,138
Recoveries, net of loans charged off	<u>62</u>
Balance at 9-30-01	<u>\$21,600</u>
Balance at 12-31-01	\$22,100
(Reversal of) provision for loan losses	1,824
Loans (charged off), net of recoveries	<u>(24)</u>
Balance at 9-30-02	<u>\$23,900</u>