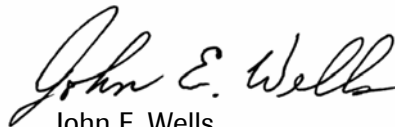


# **SECOND QUARTER 2007**

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David E. Lawrence  
Chief Executive Officer



John E. Wells  
Chairman of the Board

July 27, 2007

# 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 June 30, 2007. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2006 Annual Report of the Association. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

## **LOAN PORTFOLIO**

The Association provides funds to farmers, rural homeowners and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans. The Association's loan portfolio is diversified over a range of agricultural commodities in our region, including livestock, timber, 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.

As of June 30, 2007, the gross loan volume of the Association was \$1,421,803. This was an increase of \$92,021 or 6.92 percent as compared to \$1,329,782 at December 31, 2006. The increase in gross loan volume was due to the continued demand for farm and real estate loans. Net loans outstanding at June 30, 2007, were \$1,419,270 as compared to \$1,327,337 at December 31, 2006. Net loans were 95.43 percent of total assets at June 30, 2007.

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 decreased slightly from \$3,886 at December 31, 2006, to \$3,484 at June 30, 2007. The decrease was primarily the result of payments received on several loans.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio. Factors considered in determining the allowance for loan losses were generally based on recent historical charge-off experience adjusted for relevant environmental factors. The allowance for loan losses at June 30, 2007, was \$2,533.

## **RESULTS OF OPERATIONS**

### ***For the three months ended June 30, 2007***

Net income for the three months ended June 30, 2007 totaled \$8,060, as compared to \$6,388 for the same period in 2006, an increase of \$1,672 or 26.17 percent. The increase in net income was primarily due to an increase in net interest income and a refund of state income taxes related to the Association's long-term mortgage lending activities prior to 2001.

Net interest income increased \$503, or 6.04 percent, for the three months ended June 30, 2007, as compared to the same period in 2006. The increase in net interest income was primarily due to an increase in loan volume and higher return on investments that are tied to short-term interest rates when compared to same period last year.

Noninterest income for the three months ended June 30, 2007, totaled \$3,261, as compared to \$2,359 for the same period of 2006, an increase of \$902 or 38.24 percent. The increase was primarily due to an increase in equity in earnings of AgFirst Farm Credit Bank and interest on the refund of state income taxes. Equity in earnings of AgFirst Farm Credit Bank increased \$327, compared to the same period of 2006. Interest on the refund of state income taxes totaled \$488.

Noninterest expenses for the three months ended June 30, 2007 totaled \$4,469. This was an increase of \$186, or 4.34 percent, compared to the same period of 2006. The increase was mainly due to an increase in employees' salaries and benefits, an increase in occupancy and equipment expenses, and higher Farm Credit System insurance fund premium expense.

The benefit for income taxes for the three months ended June 30, 2007, total \$588 compared to a provision for income taxes of \$15 for the same period in 2006. The benefit for income taxes of \$588 was a result of a refund of state income taxes totaling \$601. The refund was due to the 2001 settlement agreement with the IRS related to the taxability of earnings from the Association's long-term mortgage lending activities prior to 2001. Virginia and Maryland agreed to the change in taxable income and issued refunds of income taxes this quarter.

### ***For the six months ended June 30, 2007***

Net income for the six months ended June 30, 2007 totaled \$14,846, as compared to \$12,479 for the same period in 2006, an increase of \$2,367 or 18.97 percent. Net interest income for the first six months increased \$1,100 compared to the same period in 2006. The increase in net interest income was

primarily due to an increase in loan volume and higher return on investments that are tied to short-term interest rates when compared to same period last year.

Noninterest income for the six months ended June 30, 2007, totaled \$6,013, as compared to \$4,684 for the same period of 2006, an increase of \$1,329. The increase was primarily due to an increase in equity in earnings of AgFirst Farm Credit Bank and interest on a refund of state income taxes.

Noninterest expenses for the six months ended June 30, 2007 totaled \$8,999. This was an increase of \$514 compared to the same period of 2006. The increase was mainly due to an increase in employees' salaries and benefits, an increase in occupancy and equipment expenses, and higher Farm Credit System insurance fund premium expense.

The benefit for income taxes for the six months ended June 30, 2007, total \$572 compared to a provision for income taxes of \$30 for the same period in 2006. The benefit for income taxes of \$572 was a result of a refund of state income taxes totaling \$601. The refund was due to the 2001 settlement agreement with the IRS related to the taxability of earnings from the Association's long-term mortgage lending activities prior to 2001. Virginia and Maryland agreed to the change in taxable income and issued refunds of income taxes this quarter.

## 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 June 30, 2007, was \$1,270,952 as compared to \$1,168,915 at December 31, 2006. The increase during the period is primarily attributed to the increase in loan volume.

## CAPITAL RESOURCES

Total members' equity at June 30, 2007 totaled \$194,661, an increase of \$14,918, as compared to \$179,743 at December 31, 2006. 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 June 30, 2007, the

Association's total surplus ratio and core surplus ratio were 10.78 percent and 10.78 percent, respectively, and the permanent capital ratio was 12.08 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.

## ACCOUNTING FOR DEFINED BENEFIT PENSION AND OTHER POSTRETIREMENT PLANS

On September 29, 2006, the Financial Accounting Standards Board 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 comprehensive income. The Standard is effective for employers with publicly traded securities for the fiscal year ending after December 31, 2006 and for employers without publicly traded securities for the fiscal year ending after June 15, 2007. The Association will be required to implement the Standard for the year ended December 31, 2007. 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 Association used a measurement date of September 30<sup>th</sup>. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. The Association is currently evaluating the impact of the implementing this Standard. It is anticipated that the impact from the implementation of this Standard will have no impact on the consolidated income statement and, based on the current funded status of the defined benefit plans, it is not expected to have a material or significant impact on the consolidated balance sheet.

**NOTE:** Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 316, or writing Wanda Martin, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, [www.agfirst.com](http://www.agfirst.com). Copies of the Association's annual and quarterly reports are also available upon request free of charge by calling 540-886-3435, ext. 620, or writing David Sauer, Farm Credit of the Virginias, ACA, P.O. Box 899, Staunton, VA 24402, or accessing the website, [www.farmcreditofvirginias.com](http://www.farmcreditofvirginias.com). The Association prepares a quarterly report within 45 days after the end of each fiscal quarter, except no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

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

<i>(dollars in thousands)</i>	<b>June 30, 2007</b> <i>(unaudited)</i>	<b>December 31, 2006</b> <i>(audited)</i>
<b>Assets</b>		
Cash	\$ 2,000	\$ 2,716
Loans	1,421,803	1,329,782
Less: allowance for loan losses	2,533	2,445
Net loans	1,419,270	1,327,337
Other investments, held to maturity	14,405	10,401
Accrued interest receivable	14,132	10,645
Investment in other Farm Credit institutions	18,304	18,304
Premises and equipment, net	6,066	6,247
Other property owned	796	—
Deferred tax asset, net	9	9
Prepaid retirement expense	4,622	5,114
Due from AgFirst Farm Credit Bank	4,528	9,844
Other assets	3,084	2,511
Total assets	\$ 1,487,216	\$ 1,393,128
<b>Liabilities</b>		
Notes payable to AgFirst Farm Credit Bank	\$ 1,270,952	\$ 1,168,915
Accrued interest payable	6,220	5,587
Patronage refund payable	54	18,204
Postretirement benefits other than pensions	6,611	6,483
Minimum pension liability	118	119
Other liabilities	8,600	14,077
Total liabilities	1,292,555	1,213,385
Commitments and contingencies		
<b>Members' Equity</b>		
Capital stock and participation certificates	18,384	18,318
Retained earnings		
Allocated	55,216	54,845
Unallocated	121,061	106,580
Total members' equity	194,661	179,743
Total liabilities and members' equity	\$ 1,487,216	\$ 1,393,128

*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 June 30,</b>		<b>For the six months ended June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Interest Income</b>				
Loans	\$ 26,891	\$ 22,814	\$ 52,451	\$ 44,259
Other	197	149	345	274
Total interest income	27,088	22,963	52,796	44,533
<b>Interest Expense</b>				
Notes payable to AgFirst Farm Credit Bank	18,258	14,636	35,386	28,223
Net interest income	8,830	8,327	17,410	16,310
Provision for (reversal of allowance for) loan losses	150	—	150	—
Net interest income after provision for (reversal of allowance for) loan losses	8,680	8,327	17,260	16,310
<b>Noninterest Income</b>				
Loan fees	231	170	480	375
Fees for financially related services	11	12	35	32
Equity in earnings of other Farm Credit institutions	2,340	2,013	4,528	3,919
Other noninterest income	679	164	970	358
Total noninterest income	3,261	2,359	6,013	4,684
<b>Noninterest Expense</b>				
Salaries and employee benefits	2,527	2,479	5,247	5,165
Occupancy and equipment	359	325	701	628
Insurance Fund premium	515	456	1,006	894
Other operating expenses	1,039	1,023	2,021	1,833
Losses (gains) on other property owned, net	29	—	24	(35)
Total noninterest expense	4,469	4,283	8,999	8,485
Income before income taxes	7,472	6,403	14,274	12,509
Provision (benefit) for income taxes	(588)	15	(572)	30
Net income	\$ 8,060	\$ 6,388	\$ 14,846	\$ 12,479

*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)*

*(dollars in thousands)*

	<b>Capital Stock and Participation Certificates</b>	<b>Retained Earnings</b>		<b>Total Members' Equity</b>
		<b>Allocated</b>	<b>Unallocated</b>	
Balance at December 31, 2005	\$ 18,568	\$ 60,085	\$ 104,480	\$ 183,133
Net income			12,479	12,479
Capital stock/participation certificates issued	474			474
Capital stock/participation certificates retired	(701)			(701)
Retained earnings retired		(23)		(23)
Distribution adjustment		(893)	104	(789)
Balance at June 30, 2006	<u>\$ 18,341</u>	<u>\$ 59,169</u>	<u>\$ 117,063</u>	<u>\$ 194,573</u>
Balance at December 31, 2006	\$ 18,318	\$ 54,845	\$ 106,580	\$ 179,743
Net income			14,846	14,846
Capital stock/participation certificates issued	1,197			1,197
Capital stock/participation certificates retired	(1,131)			(1,131)
Distribution adjustment		371	(365)	6
Balance at June 30, 2007	<u>\$ 18,384</u>	<u>\$ 55,216</u>	<u>\$ 121,061</u>	<u>\$ 194,661</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, 2006, are contained in the 2006 Annual Report to Shareholders. These unaudited second quarter 2007 consolidated financial statements should be read in conjunction with the 2006 Annual Report to Shareholders.

On September 29, 2006, the Financial Accounting Standards Board 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 comprehensive income. The Standard is effective for employers with publicly traded securities for the fiscal year ending after December 15, 2006 and for employers without publicly traded securities for the fiscal year ending after June 15, 2007. The Association will be required to implement the Standard for the year ended December 31, 2007. 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 Association 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. The Association is currently evaluating the impact of implementing this Standard. It is anticipated that the impact from the implementation of this Standard will have no impact on the consolidated income statement and, based on the current funded status of the defined benefit plans, it is not expected to have a material or significant impact on the consolidated balance sheet.

The accompanying consolidated financial statements contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations and conform with generally accepted accounting principles. The results for the six months ended June 30, 2007, are not necessarily indicative of the results to be expected for the year ending December 31, 2007.

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

The Association maintains an allowance for loan losses in accordance with generally accepted accounting principles. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of June 30, 2007,

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:

	For the six months ended June 30,	
	2007	2006
Balance at beginning of period	\$ 2,445	\$ 2,736
Provision for (reversal of) loan losses	150	–
Loans (charged off), net of recoveries	(62)	(106)
Balance at end of period	<u>\$ 2,533</u>	<u>\$ 2,630</u>

### NOTE 3 – EMPLOYEE BENEFIT PLANS

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

The following is a table of retirement and postretirement benefit expense:

	For the six months ended June 30,	
	2007	2006
Pension	\$ 495	\$ 560
Thrift/deferred compensation	141	133
Other postretirement benefits	292	295
Total	<u>\$ 928</u>	<u>\$ 988</u>

As of June 30, 2007, no contributions have been made to the pension plan for 2007. Actuarial projections as of the last plan measurement date (September 30, 2006) did not anticipate any contributions for 2007; however, market conditions could impact discount rates and return on plan assets which could change this expectation, making contributions necessary before the next plan measurement date.

The Association also sponsors supplemental retirement and deferred compensation plans for certain key employees. The expenses of these plans are included in the pension and deferred compensation costs above. The Association contributed \$4 to these plans during the first six months of 2007. The Association anticipates making additional contributions of \$5 to these supplemental retirement and deferred compensation plans during the remainder of 2007.