
VYFC 10-Q 9/30/2008

Section 1: 10-Q (FORM 10-Q)

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended September 30, 2008

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 000-28342

VALLEY FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

VIRGINIA
(State or other jurisdiction of
incorporation or organization)

54-1702380
(I.R.S. Employer
Identification No.)

36 Church Avenue, S.W.
Roanoke, Virginia
(Address of principal executive offices)

24011
(Zip Code)

(540) 342-2265
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address, and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by checkmark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act.) Yes No

At November 12, 2008, 4,678,851 shares of common stock, no par value, of the registrant were outstanding.

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VALLEY FINANCIAL CORPORATION
FORM 10-Q
September 30, 2008

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Cautionary Statement Regarding Forward-Looking Statements

This report contains statements concerning the Company's expectations, plans, objectives, future financial performance, and other statements that are not historical facts. These statements may constitute "forward-looking statements" as defined by federal securities laws. These statements may address issues that involve estimates and assumptions made by management and risks and uncertainties. Actual results could differ materially from historical results or those anticipated by such statements. Factors that could have a material adverse effect on the operations and future prospects of the Company include, but are not limited to, changes in:

1. interest rates
2. general economic conditions, either nationally or regionally
3. the legislative/regulatory climate
4. monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board
5. demand for loan products
6. deposit flows
7. competitive pressures among depository and other financial institutions
8. demand for financial services in our market area
9. technology and
10. accounting principles, policies and guidelines.

The above risks are exacerbated by the recent developments in national and international financial markets, and we are unable to predict what effect these uncertain market conditions will have on our company. During 2008, the capital and credit markets have experienced extended volatility and disruption. In the last 90 days, the volatility and disruption have reached unprecedented levels. While there can be no assurance that these unprecedented recent developments will not materially and adversely affect our business, financial condition and results of operations, we did not participate in the subprime, Alt-A or third-party originated mortgage programs that have resulted in heavy loan losses at many banks throughout the country. Additionally, we do not hold any preferred stock or sub-debt of Fannie Mae or Freddie Mac and therefore did not incur any write-downs related to the conservatorship of these entities during the third quarter.

These risks and uncertainties should be considered in evaluating the forward-looking statements contained herein. We caution readers not to place undue reliance on those statements, which speak only as of the date of this report.

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VALLEY FINANCIAL CORPORATION
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

	(Unaudited) 9/30/08	(Audited) 12/31/07
Assets		
Cash and due from banks	\$ 6,756	\$ 10,895
Interest-bearing deposits in banks	96	95
Federal funds sold	12,392	—
Securities available-for-sale	69,563	58,540
Securities held-to-maturity (approximate market values of \$11,111 at September 30, 2008 and \$17,666 at December 31, 2007)	11,101	17,582
Restricted equity securities	5,517	4,963
Loans, net of allowance for loan losses of \$5,378 at September 30, 2008 and \$4,883 at December 31, 2007	508,939	482,281
Foreclosed assets, net	500	445
Premises and equipment, net	8,161	6,463
Bank owned life insurance	12,260	11,639
Accrued interest receivable	2,667	2,975
Other assets	4,876	5,089
Total assets	<u>\$ 642,828</u>	<u>\$600,967</u>
Liabilities and Shareholders' Equity		
Liabilities:		
Noninterest-bearing deposits	\$ 18,345	\$ 16,362
Interest-bearing deposits	443,586	416,091
Total deposits	<u>461,931</u>	<u>432,453</u>
Federal funds purchased and securities sold under agreements to repurchase	35,418	36,582
Short-term borrowings	12,000	13,000
Long-term borrowings	68,000	55,000
Guaranteed preferred beneficial interests in the Company's junior subordinated debentures	16,496	16,496
Accrued interest payable	4,157	3,828
Other liabilities	2,278	2,892
Total liabilities	<u>600,280</u>	<u>560,251</u>
Commitments and other contingencies	—	—
Shareholders' equity:		
Preferred stock, no par value. Authorized 10,000,000 shares; none issued and outstanding	—	—
Common stock, no par value. Authorized 10,000,000 shares; issued and outstanding 4,674,651 at September 30, 2008 and 4,593,581 at December 31, 2007, respectively	22,381	21,879
Retained earnings	20,274	18,801
Cumulative effect of the change in accounting principle on retained earnings	178	—
Accumulated other comprehensive income (loss)	(285)	36
Total shareholders' equity	<u>42,548</u>	<u>40,716</u>
Total liabilities and shareholders' equity	<u>\$ 642,828</u>	<u>\$600,967</u>

See accompanying notes to consolidated financial statements.

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VALLEY FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(In thousands, except share and per share data)

	3 Months Ended		9 Months Ended	
	9/30/08	9/30/07	9/30/08	9/30/07
Interest Income:				
Interest and fees on loans	\$7,822	\$8,994	\$23,792	\$26,311
Interest on securities—taxable	1,032	854	3,096	2,409
Interest on securities-nontaxable	90	109	293	362
Interest on deposits in banks	42	27	59	136
Total interest income	<u>8,986</u>	<u>9,984</u>	<u>27,240</u>	<u>29,218</u>
Interest Expense:				
Interest on deposits	3,487	4,476	11,059	13,074
Interest on short-term borrowings	106	371	405	964
Interest on long-term borrowings	720	485	1,827	1,617
Interest on guaranteed preferred beneficial interests in the Company's junior subordinated debentures	196	302	646	892
Interest on federal funds purchased and securities sold under agreements to repurchase	187	390	664	1,026
Total interest expense	<u>4,696</u>	<u>6,024</u>	<u>14,601</u>	<u>17,573</u>
Net interest income	4,290	3,960	12,639	11,645
Provision for loan losses				
Net interest income after provision for loan losses	<u>3,855</u>	<u>3,478</u>	<u>11,525</u>	<u>10,321</u>
Noninterest Income:				
Service charges on deposit accounts	288	284	839	889
Income earned on bank owned life insurance	143	131	421	388
Other income on real estate loans	10	20	25	53
Realized losses on sale of securities	—	—	(14)	(50)
Realized gains on disposal of derivative instruments	—	—	—	51
Realized gain/(loss) on disposal of equipment	(4)	(4)	(6)	(4)
Other income	235	138	601	442
Total noninterest income	<u>672</u>	<u>569</u>	<u>1,866</u>	<u>1,769</u>
Noninterest Expense:				
Compensation expense	1,863	1,592	5,453	4,875
Occupancy expense	227	180	666	560
Equipment expense	159	131	483	409
Data processing expense	189	182	601	493
Advertising and marketing expense	84	65	386	221
Insurance	97	90	306	259
Audit fees	63	85	184	273
Legal	90	70	166	150
Franchise tax expense	100	85	301	254
Business manager expense	71	64	166	215
Deposit expense	79	56	189	184
Loan expenses	60	50	152	126
Computer software expense	112	94	336	260
Foreclosed asset expenses, net	5	—	22	1
Other expense	341	350	999	1,061
Total noninterest expense	<u>3,540</u>	<u>3,094</u>	<u>10,410</u>	<u>9,341</u>
Income before income taxes	987	953	2,981	2,749
Income tax expense				
	<u>270</u>	<u>343</u>	<u>828</u>	<u>746</u>
Net income	<u>\$ 717</u>	<u>\$ 610</u>	<u>\$ 2,153</u>	<u>2,003</u>

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Earnings per share

Basic earnings per share	<u>\$ 0.15</u>	<u>\$ 0.15</u>	<u>\$ 0.46</u>	<u>\$ 0.48</u>
Diluted earnings per share	<u>\$ 0.15</u>	<u>\$ 0.14</u>	<u>\$ 0.46</u>	<u>0.47</u>
Weighted average shares outstanding	<u>4,661,202</u>	<u>4,187,268</u>	<u>4,635,668</u>	<u>4,158,134</u>
Diluted average shares outstanding	<u>4,662,374</u>	<u>4,236,253</u>	<u>4,652,635</u>	<u>4,229,725</u>
Dividends declared per share	<u>—</u>	<u>—</u>	<u>\$ 0.07</u>	<u>\$ 0.07</u>

See accompanying notes to consolidated financial statements.

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VALLEY FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands, except share and per share data)

	9 Months Ended	
	9/30/08	9/30/07
<i>Cash flows from operating activities</i>		
Net income	\$ 2,153	\$ 2,003
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,114	1,324
Depreciation and amortization	629	606
Stock option expense	75	108
Decrease in deferred income tax	469	185
Net losses on sale of securities	14	50
Net gains on disposal of derivative instruments	—	(51)
Net losses on disposal of fixed assets	6	3
Net (gains) on sale of foreclosed assets	(6)	
Net amortization of bond premiums/discounts	111	114
Increase in unearned fees	(158)	(39)
(Increase) decrease in accrued interest receivable	308	(438)
(Increase) decrease in other assets	(275)	726
Increase in value of life insurance contracts	(421)	(388)
Increase in accrued interest payable	329	1,461
Decrease in other liabilities	(470)	(436)
Net cash provided by operating activities	<u>3,878</u>	<u>5,228</u>
<i>Cash flows from investing activities</i>		
Increase in interest-bearing deposits in banks	(1)	(3)
(Increase) decrease in federal funds sold	(12,392)	16,630
Purchases of premises and equipment	(2,312)	(260)
Purchases of securities available-for-sale	(28,842)	(15,954)
Purchases of restricted equity securities	(1,229)	(109)
Proceeds from sales/calls/paydowns/maturities of securities available-for-sale	17,438	6,451
Proceeds from paydowns on securities held-to-maturity	6,416	2,357
Principal repayments of restricted equity securities	675	450
Purchase of bank owned life insurance	(200)	—
Proceeds from sale of foreclosed properties	802	—
Capitalized expenses on foreclosed assets	(286)	—
Increase in loans, net	(28,180)	(18,374)
Net cash (provided) used in investing activities	<u>(48,111)</u>	<u>(8,812)</u>
<i>Cash flows from financing activities</i>		
Increase (decrease) in noninterest-bearing deposits	1,983	(3,265)
Increase (decrease) in interest-bearing deposits	27,495	(4,245)
(Decrease) in short-term borrowings	(1,000)	(2,000)
Increase (decrease) in federal funds purchased and securities sold under agreements to repurchase	(1,164)	20,435
Increase (decrease) in long-term borrowings	13,000	(8,000)
Cash dividends paid	(646)	(580)
Proceeds from issuance of common stock	426	2,173
Net cash provided (used) by financing activities	<u>40,094</u>	<u>4,518</u>
Net increase (decrease) in cash and due from banks	<u>(4,139)</u>	<u>934</u>
Cash and due from banks at beginning of year	10,895	9,778
Cash and due from banks at end of period	<u>\$ 6,756</u>	<u>10,712</u>
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	<u>\$ 14,272</u>	<u>\$ 16,112</u>
Cash paid during the period for taxes	<u>\$ 500</u>	<u>\$ 396</u>
Noncash financing and investing activities:		

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Transfer of loans to foreclosed property	<u>\$567</u>	<u>\$—</u>
Reclassification of borrowings from long-term to short-term	<u>\$—</u>	<u>\$—</u>

See accompanying notes to consolidated financial statements.

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VALLEY FINANCIAL CORPORATION
Notes to Consolidated Financial Statements
September 30, 2008 (Unaudited)
(In thousands, except share and per share data)

(1) Organization and Summary of Significant Accounting Policies

Valley Financial Corporation (the “Company”) was incorporated under the laws of the Commonwealth of Virginia on March 15, 1994, primarily to serve as a holding company for Valley Bank (the “Bank”), which opened for business on May 15, 1995. The Company’s fiscal year end is December 31.

The consolidated financial statements of the Company conform to generally accepted accounting principles and to general banking industry practices. The interim period consolidated financial statements are unaudited; however, in the opinion of management, all adjustments of a normal recurring nature which are necessary for a fair presentation of the consolidated financial statements herein have been included. The consolidated financial statements herein should be read in conjunction with the Company’s 2007 Annual Report on Form 10-K.

The Company reports its activities as a single business segment. In determining the appropriateness of segment definition, the Company considers components of the business about which financial information is available and regularly evaluated relative to resource allocation and performance assessment.

(2) Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks. To comply with Federal Reserve regulations, the Bank is required to maintain certain average reserve balances. The daily cash reserve requirement for the two weeks including September 30, 2008 was \$119, which was met by cash on hand.

As a condition of our correspondent bank agreement, the Bank is also required to maintain a target balance. The target balance as of September 30, 2008 was \$250.

(3) Securities

The carrying values, unrealized gains, unrealized losses, and approximate fair values of available-for-sale and held-to-maturity investment securities at September 30, 2008 are shown in the tables below. As of September 30, 2008, investments (including both available-for-sale and held-to-maturity) and restricted equity securities with amortized costs and fair values of \$77,483 and \$77,493, respectively, were pledged as collateral for public deposits, a line of credit available from the Federal Home Loan Bank, customer sweep accounts, and for other purposes as required or permitted by law. At September 30, 2008 we evaluated our investment portfolio and determined all unrealized losses presented in the table below are not related to an issuer’s financial condition but are due to changes in the level of interest rates and no declines are deemed to be other than temporary in nature.

The following table sets forth the composition of securities available for sale at September 30, 2008. Securities available for sale are carried at approximate market value.

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Available-for-Sale Investment Portfolio – Category Distribution
(dollars in thousands)

	Amortized Costs	Unrealized Gains	Unrealized Losses	Approximate Fair Values
U. S. Government and federal agency	\$ 637	\$ 7	\$ —	\$ 644
Government-sponsored enterprises	21,940	105	165	21,880
Mortgage-backed securities	30,090	233	297	30,026
Collateralized mortgage obligations	13,371	29	297	13,103
States and political subdivisions	3,956	21	67	3,910
Total securities available for sale	<u>69,994</u>	<u>395</u>	<u>826</u>	<u>69,563</u>

The following table sets forth the composition of securities held to maturity at September 30, 2008. Securities held to maturity are carried at amortized cost.

Held-to-Maturity Investment Portfolio – Category Distribution
(dollars in thousands)

	Amortized Costs	Unrealized Gains	Unrealized Losses	Approximate Fair Values
Government-sponsored enterprises	\$ 2,979	\$ 26	\$ 2	\$ 3,003
Mortgage-backed securities	1,407	—	17	1,390
Collateralized mortgage obligations	510	—	17	493
States and political subdivisions	6,205	53	33	6,225
Total securities held to maturity	<u>11,101</u>	<u>79</u>	<u>69</u>	<u>11,111</u>

(4) Allowance for Loan Losses

The following table summarizes the loan loss experience for the nine-month periods ended September 30, 2008 and 2007.

Allowance for Loan Losses
(dollars in thousands)

	2008	2007
Balance at January 1	\$4,883	\$ 5,658
Provision for loan losses	1,114	1,324
Recoveries:		
Commercial	51	—
Loans to individuals	—	2
Charged off loans:		
Commercial	(165)	(1,005)
Commercial Real Estate	(252)	(605)
Residential Real Estate	(189)	—
Real Estate Construction	(43)	—

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Loans to individuals	(21)	(6)
Balance at September 30	<u>\$5,378</u>	<u>\$5,368</u>

(5) Earnings Per Share

Basic earnings per share is based upon the weighted average number of common shares outstanding during the period. The weighted average shares outstanding for the diluted earnings per share computations were adjusted to reflect the assumed conversion of shares available under stock options. The following tables summarize earnings per share and the shares utilized in the computations:

	Earnings Per Share			
	9 Months Ending		3 Months Ending	
	9/30/08	9/30/07	9/30/08	9/30/07
Basic	\$ 0.46	\$ 0.48	\$ 0.15	\$ 0.15
Diluted	\$ 0.46	\$ 0.47	\$ 0.15	\$ 0.14

	Weighted Average Shares Outstanding			
	9 Months Ending		3 Months Ending	
	9/30/08	9/30/07	9/30/08	9/30/07
Basic	4,635,668	4,158,134	4,661,202	4,187,268
Diluted	4,652,635	4,229,725	4,662,374	4,236,253

(6) Comprehensive Income

For the nine months ended September 30, 2008 and 2007, total comprehensive income (loss) was \$1,831 and \$1,935 respectively.

The information that follows discloses the reclassification adjustments and the income taxes related to the net unrealized gains (losses) on securities available-for-sale and net unrealized gains (losses) on derivatives not held for trading that are included in other comprehensive income (loss), net of income taxes for the nine- and three-month periods ended September 30, 2008 and 2007.

	9 Months Ended (dollars in thousands)		3 Months Ended (dollars in thousands)	
	9/30/08	9/30/07	9/30/08	9/30/07
Net unrealized gains (losses) on securities available for sale:				
Net unrealized holding gains (losses) during the year	\$ (500)	\$ (47)	\$ 396	\$ 711
Less reclassification adjustments for realized gains included in net income, net of tax	8	33	—	33
Net unrealized gains (losses) on derivatives not held for trading	—	(55)	—	—
Less reclassification adjustments for realized gains on derivatives included in net income, net of tax	—	(34)	—	—
Income tax benefit (expense)	<u>170</u>	<u>35</u>	<u>(135)</u>	<u>(243)</u>

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Other comprehensive income (loss), net of income taxes	<u>\$(322)</u>	<u>\$(68)</u>	<u>\$261</u>	<u>\$501</u>
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(7) Financial Instruments With Off-Balance Sheet Risk

In the normal course of business to meet the financing needs of its customers, the Company is a party to financial instruments with off-balance-sheet risk, which involve commitments to extend credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit is represented by the contractual amount of those instruments. The same credit policy is used in making commitments as is used for on-balance-sheet risk. At September 30, 2008 outstanding commitments to extend credit were \$145,490 as compared to \$144,656 at December 31, 2007.

Commitments to extend credit are agreements to lend to a customer as long as there is no breach of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments may expire without ever being drawn upon; therefore, the total commitment amounts do not necessarily represent future cash outlays for the Company.

(8) Related Party Transactions

The Bank has entered into transactions with its directors, significant shareholders and their affiliates (related parties). Such transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features. As of September 30, 2008 aggregate loans to directors, executive officers, and principal shareholders totaled \$26,617. An analysis of loan activity to directors, executive officers, and principal shareholders is as follows:

Loans to Related Parties

(dollars in thousands)

Balances as of January 1, 2008	\$ 29,450
Addition of new director/officer(s)	—
Advances	11,653
Repayments	<u>(14,486)</u>
Balances as of September 30, 2008	<u>\$26,617</u>

(9) Long-Term Federal Home Loan Bank Advances

The Company has outstanding long-term debt with the Federal Home Loan Bank of Atlanta in the amount of \$68,000 as of September 30, 2008. There are four convertible advances in the amount of \$5,000 each, one convertible advance in the amount of \$15,000, two convertible advances in the amount of \$10,000 and one fixed-rate advance in the amount of \$13,000. The Federal Home Loan Bank of Atlanta has the option to convert the four \$5,000 convertible advances on the conversion dates below, and on any quarterly

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interest payment date thereafter, with at least two business days notice. If called, these convertible advances will be converted into a 3-month London Interbank Offered Rate (“LIBOR”) based adjustable rate credit (ARC) at 3-month LIBOR. The Federal Home Loan Bank of Atlanta has the option to convert the \$15,000 and the two \$10,000 convertible advances on the conversion dates below, with at least two business days notice. If called, these advances will be converted into a 3-month LIBOR based adjustable rate credit at 3-month LIBOR plus or minus the then-current spread of such advance.

The following table provides more information on the outstanding advances as of September 30, 2008 and December 31, 2007:

LONG-TERM FEDERAL HOME LOAN BANK ADVANCES (dollars in thousands)

Advance Date	Maturity Date	Conversion Date	Current Rate	9/30/08 Balance	12/31/07 Balance
December 2, 1999	December 2, 2009	Quarterly	5.460%	\$ 5,000	\$ 5,000
May 24, 2000	May 24, 2010	Quarterly	6.490%	5,000	5,000
February 9, 2001	February 9, 2011	Quarterly	4.970%	5,000	5,000
March 11, 2003	March 11, 2013	March 11, 2008	n/a	—	7,000
June 29, 2006	June 29, 2016	n/a	5.030%	13,000	13,000
November 9, 2006	November 9, 2016	November 10, 2008	4.280%	5,000	5,000
December 28, 2007	December 28, 2010	December 28, 2009	3.785%	15,000	15,000
March 29, 2008	March 29, 2018	March 29, 2011	2.625%	10,000	—
July 22, 2008	July 23, 2018	July 25, 2011	3.530%	10,000	—
			TOTAL	\$68,000	\$55,000

(10) Guaranteed Preferred Beneficial Interests in the Company’s Junior Subordinated Debentures.

Valley Financial (VA) Statutory Trust I, a statutory business trust (the “Trust”), was created by the Company on June 26, 2003, at which time the Trust issued \$4,000 in aggregate liquidation amount of \$1 par value preferred capital trust securities which mature June 26, 2033. Distributions are payable on the securities at a floating rate equal to the 3-month London Interbank Offered Rate (“LIBOR”) plus 3.10%, capped at 11.75%, and the securities may be prepaid at par by the Trust at any time after June 26, 2008. The principal assets of the Trust are \$4,124 of the Company’s junior subordinated debentures which mature on June 26, 2033, and bear interest at a floating rate equal to the 3-month LIBOR plus 3.10%, capped at 11.75%, and which are callable by the Company after June 26, 2008. All \$124 in aggregation liquidation amount of the Trust’s common securities are held by the Company.

Valley Financial (VA) Statutory Trust II, a statutory business trust (“Trust II”), was created by the Company on September 26, 2005, at which time Trust II issued \$7,000 in aggregate liquidation amount of \$1 par value preferred capital trust securities which mature December 15, 2035. Distributions are payable on the securities at a floating rate equal to the 3-month LIBOR plus 1.49%, and the securities may be prepaid at par by Trust II at any time after December 15, 2010. The principal assets of Trust II are \$7,217 of the Company’s junior subordinated debentures which mature on December 15, 2035, and bear interest at a floating rate equal to the 3-month LIBOR plus 1.49%, and which are callable by the Company after December 15, 2010. All \$217 in aggregation liquidation amount of Trust II’s common securities are held by the Company.

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Valley Financial Statutory Trust III, a statutory business trust (“Trust III”) was created by the Company on December 15, 2006, at which time Trust III issued \$5,000 in aggregate liquidation amount of \$1 par value preferred capital trust securities which mature January 30, 2037. Distributions are payable on the securities at a floating rate equal to the 3-month LIBOR plus 1.73%, and the securities may be prepaid at par by Trust III at any time after January 20, 2012. The principal assets of Trust III are \$5,155 of the Company’s junior subordinated debentures which mature on January 30, 2037, and bear interest at a floating rate equal to the 3-month LIBOR plus 1.73%, and which are callable by the Company after January 30, 2012. All \$155 in aggregation liquidation amount of Trust III’s common securities are held by the Company.

(11) Stock Based Compensation

We account for stock-based compensation in accordance with, the Financial Accounting Standards Board’s (“FASB”) Statement of Financial Accounting Standards No 123 – revised 2004 (“SFAS 123R”), “Share-Based Payment,” (“SFAS No. 123R”) which replaced SFAS No. 123, “Accounting for Stock Based Compensation,” and supersedes APB No. 25, “Accounting for Stock Issued to Employees,” and its related interpretations. Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period, which is the vesting period. We currently use the Black-Scholes option pricing model to determine the fair value of stock options and restricted stock grants. The determination of the fair value of stock-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include our expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rate and expected dividends.

The Company has two share-based compensation plans, which are described below. The compensation cost that has been charged against income for those plans was approximately \$75 and \$108 for the nine-month periods ended September 30, 2008 and 2007, respectively and approximately \$24 and \$23 for the three-month periods ended September 30, 2008 and 2007, respectively. The Company has no nonqualified stock options outstanding at September 30, 2008. The Company recognized an income tax benefit of \$163 during the nine-month period ended September 30, 2008 as a result of the exercise of 66,733 non-qualified stock options.

Stock Option Plans

The Company has a 2005 Key Employee Equity Award Plan (the 2005 Plan). The 2005 Plan gives the Company flexibility in tailoring equity-based compensation awards for employees from time to time to the continuing objective of aligning employee incentives with the interests of shareholders as the Company grows and develops. In addition to incentive and nonqualified stock options, the 2005 Plan permits the grant of restricted stock, stock appreciation rights and stock units to persons designated as “Key Employees”. The 2005 Plan will remain in effect for ten years, subject to the right of the Board of Directors to terminate the 2005 Plan earlier, except with respect to awards made prior to and outstanding on that date which remain valid in accordance with their terms. The maximum aggregate number of shares of the Company’s common stock (no par value) that may be issued pursuant to awards made under the Plan may not exceed 250,000. Accordingly, 250,000 shares of authorized but unissued common stock are reserved for use in the 2005 Plan. Within the maximum limits, the Plan specifies that stock appreciation rights may not be granted with respect to more than 500 shares per recipient (2,000 shares for a new employee recipient) per year; and restricted shares and stock units, respectively, may not be granted for more than 5,000 shares per year per recipient. Under the 2005 Plan, there are options for 109,550 shares granted to officers and key employees currently

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outstanding and 138,679 shares available for grant as of September 30, 2008.

Additionally, the Company has a 1995 Incentive Stock Plan (the 1995 Plan) pursuant to which the Human Resources Committee of the Company's Board of Directors may grant stock options to officers and key employees. The 1995 Plan authorizes grants of options to purchase up to 311,850 shares (adjusted for stock splits) of the Company's authorized but unissued common stock. Under the 1995 Plan, there are options for 112,132 shares granted to officers and key employees currently outstanding and 20,841 shares available for grant as of September 30, 2008.

All stock options (for both plans) have been granted with an exercise price equal to the stock's fair market value at the date of the grant. Stock options under the Plan generally have 10-year terms, vest at the rate of 20 percent per year, and become fully exercisable five years from the date of the grant. The share-based awards granted under the aforementioned Plans have similar characteristics, except that some awards have been granted in options and certain awards have been granted in restricted stock. Therefore, the following disclosures have been disaggregated for the stock option and restricted stock awards of the Plans due to their dissimilar characteristics.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model. The risk-free interest rate is based on the U.S. Treasury rate for the expected life at the time of grant. Volatility is based on the volatilities of our trading history. The expected life is based on the average life of the options of 10 years and the weighted average vesting period of 5 years, and forfeitures are estimated based on the Company's history. The following table illustrates the assumptions for the Black-Scholes model used in determining the fair value of options granted to employees for the nine-month period ended September 30, 2008 and 2007.

	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Dividend yield	2.0%	1.0%
Risk-free interest rate	3.7%	4.5%
Volatility	39.1%	20.9%
Expected life	7.5 years	7.3 years

Total stock-based compensation recognized as compensation expense on our consolidated statement of income is as follows:

	3 Months Ended (dollars in thousands)		9 Months Ended (dollars in thousands)	
	9/30/08	9/30/07	9/30/08	9/30/07
Option Grants	\$ 24	\$ 23	\$ 75	\$ 86
Restricted Stock Grants	—	—	—	22
Total Compensation Expense	\$ 24	\$ 23	\$ 75	\$ 108

The restricted stock grant expense for the nine months ended September 30, 2007 relates to one grant of 1,771 shares that was granted and fully vested during the first quarter of 2008 to an officer of the Company who is not a Named Executive Officer, as defined in the Company's proxy statement for the 2008

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Annual Meeting of Shareholders.

As of September 30, 2008, there was \$292 of unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested stock-based payments granted to employees. A maturity schedule of the unrecognized compensation cost as of September 30, 2008 is as follows:

	<u>Remaining 2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>Total</u>
Compensation Cost	\$ 27	\$103	\$ 75	\$ 53	\$ 30	\$ 4	\$292

Total unrecognized compensation cost will be adjusted for future grants and future changes in estimated forfeitures.

General Stock Option Information

A summary of option activity under the stock option plans during the nine-month period ended September 30, 2008 is presented below:

	<u>Options Outstanding</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Grant Date Fair Value</u>	<u>Intrinsic Value of Options Exercised</u>	<u>Weighted Average Contractual Term</u>
Balance at 12/31/07	298,715	\$ 7.68	\$ 4.87	\$ 440	4.18 years
Exercised	(90,433)	3.72	6.15	300	
Forfeited	(10,200)	11.54	2.84		
Granted	23,600	8.75	3.40		
Expired	—	—	—		
Balance at 9/30/08	221,682	\$ 9.23	\$ 4.29	\$ 300	5.40 years
Exercisable at 9/30/08	134,122	\$ 7.99	\$ 4.51	\$ n/a	3.39 years

Cash received from option exercises under all share-based payment arrangements for the three- and nine-month periods ended September 30, 2008 was \$126 and \$263, respectively. Cash received from option exercises for the three- and nine-month periods ended September 30, 2007 was \$15 and \$324, respectively.

Information regarding shares vested during the nine-month periods ended September 30, 2008 and 2007 are as follows:

<u>Nine-Month Period Ending</u>	<u>Number of Shares Vested</u>	<u>Total Fair Value of Shares Vested (dollars in thousands)</u>
September 30, 2008	17,100	\$ 64
September 30, 2007	21,280	\$ 53

There were 9,560 shares vested during the three-month period ended September 30, 2008, with a weighted average exercise price of \$4.12 per option. There were 10,860 shares vested during the three-

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month period ended September 30, 2007, with a weighted average exercise price of \$3.94 per option.

Information regarding the stock options outstanding at September 30, 2008 is summarized below:

Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$3.82 - \$5.94	78,432	1.34 years	\$ 5.21	78,432	\$ 5.21
\$5.95 - \$12.85	118,200	7.84 years	\$ 10.92	41,780	\$ 11.24
\$12.86 - \$14.23	25,050	6.57 years	\$ 13.82	13,910	\$ 13.93
Totals	<u>221,682</u>	5.40 years	\$ 9.23	<u>134,122</u>	\$ 7.99

The aggregate intrinsic value of options outstanding and options exercisable as of September 30, 2008 was \$43 and \$43, respectively. The aggregate intrinsic value of options outstanding and options exercisable as of September 30, 2007 was \$995 and \$991, respectively.

A summary of the status of the Company's non-vested options as of September 30, 2008 and changes during the nine-month period then ended is presented below:

	Non-Vested Options Outstanding	Weighted Average Grant Date Fair Value
Non-vested options, 12/31/07	<u>86,780</u>	<u>\$ 4.03</u>
Granted	23,600	—
Vested	(17,100)	
Forfeited	(5,720)	
Non-vested options, 9/30/08	<u>87,560</u>	<u>\$ 3.95</u>

A summary of the status of the Company's non-vested restricted stock as of September 30, 2008 and changes during the nine-month period then ended is presented below:

	Non-Vested Restricted Stock Outstanding	Weighted Average Grant Date Fair Value
Balance, 12/31/07	<u>12,225</u>	<u>\$ 12.52</u>
Granted	—	
Vested	—	
Forfeited	(12,225)	
Balance, 9/30/08	<u>—</u>	<u>\$ 0.00</u>

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All non-vested restricted stock grants outstanding as of December 31, 2007 were automatically forfeited on January 31, 2008 as the performance goals associated with these grants were not met. No compensation expense was recognized for the grants.

(12) Restatement of Beginning Retained Earnings

In September 2006, the FASB ratified the consensuses reached by the FASB's Emerging Issues Task Force (EITF) relating to EITF 06-4, "Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" ("EITF 06-4"). Entities purchase life insurance for various reasons including protection against loss of key employees and to fund postretirement benefits. The two most common types of life insurance arrangements are endorsement split dollar life, which the Company owns, and collateral assignment split dollar life. EITF 06-4 covers the former and EITF 06-10 covers the latter. EITF 06-4 states that entities with endorsement split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods should recognize a liability for future benefits in accordance with SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions", (if, in substance, a postretirement benefit plan exists), or Accounting Principles Board ("APB") Opinion No. 12, "Omnibus Opinion -1967" (if the arrangement is, in substance, an individual deferred compensation contract). Effective January 1, 2008, the Company recognized the effects of applying this issue as a change in accounting principle through a cumulative-effect adjustment to retained earnings. The reduction of beginning retained earnings resulting from the cumulative-effect of the adoption of EITF 06-4 was \$178. Expense amounting to approximately \$18 was recognized in compensation expense in the nine-month period ended September 30, 2008.

(13) Fair Value

The Company utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available-for-sale, trading securities, and derivatives, if present, are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as loans held for sale, loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Fair Value Hierarchy

Under SFAS 157, the Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level 1 Valuation is based upon quoted prices for identical instruments traded in active markets.
- Level 2 Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

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Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

Investment Securities Available-for-Sale

Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with SFAS 114, "Accounting by Creditors for Impairment of a Loan", (SFAS 114). The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At September 30, 2008, all of the total impaired loans were evaluated based on the fair value of the collateral. In accordance with SFAS 157, impaired loans where an allowance is established based on the fair value of the collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3.

Foreclosed Assets

Foreclosed assets are adjusted to fair value upon transfer of the loans to foreclosed assets. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed asset as nonrecurring Level 2. When the appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset as nonrecurring Level 3.

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Assets and Liabilities Recorded at Fair Value on a Recurring Basis

(dollars in thousands)
September 30, 2008

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Investment securities available-for-sale	\$69,563	\$22,524	\$47,039	\$ —
Total assets at fair value	\$69,563	\$22,524	\$47,039	\$ —
Total liabilities at fair value	\$ —	\$ —	\$ —	\$ —

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

The Company may be required from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis are included in the table below.

(dollars in thousands)
September 30, 2008

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Impaired loans	\$6,643	\$ —	\$6,643	\$ —
Foreclosed assets	500	—	500	—
Total assets at fair value	\$7,143	\$ —	\$7,143	\$ —
Total liabilities at fair value	\$ —	\$ —	\$ —	\$ —

(14) Other Items

On July 1, 2008, the Company paid its ninth consecutive semi-annual cash dividend on the Company's stock, in the amount of \$0.07 per share, payable on to shareholders of record May 30, 2008.

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

Management's discussion and analysis of the financial condition and results of operations of the Company as of and for the three- and nine-months ended September 30, 2008 and 2007 is as follows. The discussion should be read in conjunction with the Company's Consolidated Financial Statements and Notes on the December 31, 2007 Form 10-K.

Recent Market Developments

The global and U.S. economies are experiencing significantly reduced business activity as a result of, among other factors, disruptions in the financial system during the past year. Dramatic declines in the housing market during the past year, with falling home prices and increasing foreclosures and unemployment, have resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities and major commercial and investment banks. These write-downs, initially of

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residential-related loans and mortgage-backed securities, but spreading to credit default swaps and other derivative securities have caused many financial institutions to seek additional capital, to merge with larger and stronger institutions and, in some cases, to fail.

Reflecting concern about the stability of the financial markets generally and the strength of counterparties, many lenders and institutional investors have reduced, and in some cases, ceased to provide funding to borrowers, including other financial institutions. The availability of credit, confidence in the financial sector, and level of volatility in the financial markets have been significantly adversely affected as a result. In recent weeks, volatility and disruption in the capital and credit markets has reached unprecedented levels. In some cases, the markets have produced downward pressure on stock prices and credit capacity for certain issuers without regard to those issuers' underlying financial strength.

In response to the financial crises affecting the banking system and financial markets and going concern threats to investment banks and other financial institutions, the Emergency Economic Stabilization Act of 2008 ("EESA") was signed into law on October 3, 2008. Pursuant to the EESA, the U.S. Treasury was given the authority to, among other things, purchase up to \$700 billion of mortgages, mortgage-backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the U.S. financial markets.

On October 3, 2008, the FDIC increased its insurance coverage limits on all deposits from \$100,000 to \$250,000 per account until December 31, 2009.

On October 14, 2008, Secretary Paulson, after consulting with the Federal Reserve and the FDIC, announced that the Department of the Treasury will purchase equity stakes in certain banks and thrifts. Under this program, known as the Troubled Asset Relief Program Capital Purchase Program (the "TARP Capital Purchase Program"), the Treasury will make \$250 billion of capital available to U.S. financial institutions in the form of preferred stock (from the \$700 billion authorized by the EESA). In conjunction with the purchase of preferred stock, the Treasury will receive warrants to purchase common stock with an aggregate market price equal to 15% of the preferred investment. Participating financial institutions will be required to adopt the Treasury's standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under the TARP Capital Purchase Program. Secretary Paulson also announced that nine large financial institutions agreed to participate in the TARP Capital Purchase Program.

Also on October 14, 2008, after receiving a recommendation from the boards of the FDIC and the Federal Reserve, and consulting with the President, Secretary Paulson signed the systemic risk exception to the FDIC Act, enabling the FDIC to temporarily provide a 100% guarantee of the senior unsecured debt of all FDIC-insured institutions and their holding companies, as well as deposits in noninterest-bearing transaction deposit accounts under a Temporary Liquidity Guarantee Program through December 31, 2009. Coverage under the Temporary Liquidity Guarantee Program is available for 30 days without charge (subsequently extended to December 5, 2008) and thereafter at a cost of 75 basis points per annum for senior unsecured debt and 10 basis points per annum for noninterest-bearing transaction deposits.

The Company has decided to take the initial steps necessary to participate in the TARP Capital Purchase Program, which based on the program guidelines, would range from \$5.3 to \$16.0 million of capital; however, the Company is still evaluating the program and has not determined whether it will participate nor has it received acceptance by the Department of the Treasury to participate. Additionally, the Company has decided to proceed with the Temporary Liquidity Guarantee Program related to noninterest-bearing deposit accounts after the initial period of November 12, 2008; however, the Company will not

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participate in the Temporary Liquidity Guarantee Program relative to the guarantee of applicable unsecured obligations, as the Company had no such unsecured obligations at September 30, 2008.

It is not clear at this time what impact the EESA, the TARP Capital Purchase Program, the Temporary Liquidity Guarantee Program, or other liquidity and funding initiatives will have on the financial markets and the other difficulties described above, including the high levels of volatility and limited credit availability currently being experienced, or on the U.S. banking and financial industries and the broader U.S. global economies. Further adverse effects could have an adverse effect on the Company and its business.

Critical Accounting Policies

The preparation of financial statements requires us to make estimates and assumptions. Those accounting policies that require our most difficult, subjective or complex judgments and uncertainties include (1) the allowance for loan losses and (2) impaired loans. Further information about these critical policies is described below.

Certain credit risks are inherent in making loans. We seek to prudently assess these risks and manage them effectively. We have internal credit policies and procedures in place to reduce repayment risks. These policies and procedures include:

- officer and customer limits
- periodic loan documentation review, and
- follow-up on exceptions to credit policies.

We establish the allowance for loan losses through charges to earnings through a provision for loan losses. Loan losses are charged against the allowance when we believe that the collection of the principal is unlikely. Subsequent recoveries of losses previously charged against the allowance are credited to the allowance. The allowance represents an amount that, in our judgment, will be appropriate to absorb probable losses on existing loans that may become uncollectible. Some of the factors we consider in determining the appropriate level of the allowance for loan losses are as follows:

- an evaluation of the current loan portfolio
- identified loan problems
- loan volume outstanding
- past loss experience
- present and expected industry and economic conditions and, in particular, how such conditions relate to our market area
- problem loan trends over a 3-year historical time period
- loan growth trends over a 3-year historical time period

The general component of the reserve covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect our estimate of probable losses. It also reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. The allowance for loan losses is evaluated on a regular basis by management. On a quarterly basis, we perform a detailed analysis of the allowance for loan losses to verify the adequacy and appropriateness of the allowance in meeting possible losses in the loan portfolio.

In analyzing our current portfolio to determine the appropriate level of the allowance for loan losses,

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we first segregate our portfolio into loans within the scope of FAS 114 (potentially impaired loans) and FAS 5 (non-impaired loan pools). Included in our potentially impaired loan category are our current “watch list” credits plus any additional credits which have been past due three or more times within the past 12-month period. We individually review these potentially impaired loans under FAS 114 and make a determination if the loan in fact is impaired. We consider a loan impaired when we determine that it is probable that we will be unable to collect all interest and principal payments as scheduled in the loan agreement. We do not consider a loan impaired during a period of delay in payment if we expect the ultimate collection of all amounts due. If it is found to be impaired, an allowance is established when the collateral value, discounted cash flows, or observable market price of the impaired loan is lower than the carrying value of that loan. We recognize any impairment by creating a valuation allowance with a corresponding charge to the provision for loan losses or by adjusting an existing valuation allowance for the impaired loan with a corresponding charge or credit to bad-debt expense. The valuation allowance becomes our “specific reserve” for the specific loan.

We take the balance of our portfolio and add back to it any loans that were included in the potentially impaired loan category but that were found not to be impaired. We then segregate the remaining portfolio into specific categories based on type of loan and review the groups of loans to estimate loss under FAS 5 (accounting rules for loss contingencies). We apply a specific loss factor to each category based upon our historical loss experience for each category of loans over the previous five years. The loss factor is multiplied by the outstanding balance in the loan category to estimate potential loss for our allowance for loan losses. We then evaluate certain environmental and qualitative factors that are relevant to our portfolio and make a risk assessment of low, medium, or high for each factor. An additional loss factor is assigned to the portfolio according to the risk assessment. This evaluation is inherently subjective, because it requires estimates that may be significantly revised as more information becomes available.

Bank regulators also periodically review the loan portfolio and other assets to assess their quality, and we employ independent, third party loan reviewers as well. This evaluation is inherently subjective because it requires estimates that may be significantly revised as more information becomes available.

We believe the allowance for loan losses is appropriate to provide for expected losses in the loan portfolio, but there are no assurances that it will be.

Overview

The Company was incorporated as a Virginia stock corporation on March 15, 1994, primarily to own and control all of the capital stock of the Bank. The Bank opened for business on May 15, 1995. There are currently eight full-service branch locations, operating in various locations throughout the Cities of Roanoke and Salem, Town of Vinton, and the County of Roanoke. The Bank also has a wealth management subsidiary, Valley Wealth Management Services, Inc. which markets investment and insurance products. Net income derived for the wealth management subsidiary is not significant at this time.

Performance Summary

The following table shows our key performance ratios for the periods ended September 30, 2008, December 31, 2007 and September 30, 2007:

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**Year To Date
Key Performance Ratios**

	9 months Ended 9/30/08	12 months Ended 12/31/07	9 months Ended 9/30/07
Return on average assets	0.46%	0.50%	0.46%
Return on average equity (1)	6.83%	8.03%	7.63%
Net interest margin (2)	2.89%	2.84%	2.85%
Cost of funds	3.40%	4.31%	4.34%
Yield on earning assets	6.18%	7.03%	7.08%
Basic net earnings per share	\$ 0.46	\$ 0.69	\$ 0.48
Diluted net earnings per share	\$ 0.46	\$ 0.68	\$ 0.47

(1) The calculation of ROE excludes the effect of any unrealized gains or losses on investment securities available-for-sale.

(2) Calculated on a fully taxable equivalent basis ("FTE")

The following table shows our key performance ratios for the quarters ended September 30, 2008 and 2007:

**Quarterly
Key Performance Ratios**

	3 months Ended 9/30/08	3 months Ended 9/30/07
Return on average assets	0.45%	0.41%
Return on average equity (1)	6.65%	6.74%
Net interest margin (2)	2.85%	2.84%
Cost of funds	3.18%	4.37%
Yield on earning assets	5.93%	7.10%
Basic net earnings per share	\$ 0.15	\$ 0.15
Diluted net earnings per share	\$ 0.15	\$ 0.14

(1) The calculation of ROE excludes the effect of any unrealized gains or losses on investment securities available-for-sale.

(2) Calculated on a fully taxable equivalent basis ("FTE")

Non-GAAP Financial Measures

The Company measures the net interest margin as an indicator of profitability. The net interest margin is calculated by dividing tax-equivalent net interest income by total average earning assets. Because a portion of interest income earned by the Company is nontaxable, the tax-equivalent net interest income is considered in the calculation of this ratio. Tax-equivalent net interest income is calculated by adding the tax benefit realized from interest income that is nontaxable to total interest income then subtracting total interest expense. The tax rate utilized in calculating the tax benefit for 2008 and 2007 is 34%. The reconciliation of tax-equivalent net interest income, which is not a measurement under GAAP, to net interest income, is reflected in the table below.

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	Three Months Ended 9/30/08	Nine months Ended 9/30/08
Net interest income, non tax-equivalent	\$4,290	\$12,639
Less: tax-exempt interest income	(89)	(293)
Add: tax-equivalent of tax-exempt interest income	135	444
Net interest income, tax-equivalent	<u>\$4,336</u>	<u>\$12,790</u>

Growth

The following table shows our key growth indicators:

Key Growth Indicators (dollars in thousands)

	9/30/08	12/31/07	9/30/07
Investment securities	\$ 86,181	\$ 81,085	\$ 80,260
Loans, net	\$508,939	\$482,281	\$482,483
Deposits	\$461,931	\$432,453	\$433,979
Total assets	\$642,828	\$600,967	\$599,592

In comparison to the same period last year, our total assets grew by \$43.2 million or 7%, net loans grew by \$26.5 million or 5% and total deposits grew by \$28.0 million or 6%. While our competitors may be pulling back on issuing credit, we continue to experience strong loan demand and strong core deposit growth from customers who prefer dealing with a local, established community bank. Our Prime Money Market account, which has an interest rate tied to the Wall Street Journal Prime rate, continues to attract customers and has accumulated over \$90 million in deposits as of the end of the third quarter of 2008, an increase of 25% over the same period last year. Additionally, we are very pleased with the results of our new checking account product, MyLifeStyle Checking, launched earlier this year. This new account is an example of how smaller community banks such as Valley Bank are finding innovative ways to compete against larger competitors in a crowded market. In addition to a great interest rate paid on this account, customers get free access to any ATM nation-wide along with many additional rewards.

Total liabilities at September 30, 2008 were \$600.3 million, up 7% from \$560.3 million at December 31, 2007 with the increase primarily represented by a \$29.5 million increase in deposits and a \$12.0 million increase in Federal Home Loan Bank advances.

Shareholders' Equity

Total shareholders' equity at September 30, 2008 was \$42.5 million compared to \$40.7 million at December 31, 2007, an increase of \$1.8 million or 4%. The change in shareholders' equity was impacted by earnings, proceeds from the exercise of incentive stock options and nonqualified stock options, the income tax benefit of the nonqualified options exercised, incentive stock option expense, the change in unrealized gains and losses for securities available-for-sale, and the cumulative effect adjustment to retained earnings

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for application of EITF Issue No. 06-10 “Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements”. This EITF requires that an employer recognize a liability for the postretirement benefit related to a collateral assignment split-dollar life insurance arrangement in accordance with either FASB Statement No. 106 or APB Opinion No. 12, as appropriate, if the employer has agreed to maintain a life insurance policy during the employee’s retirement or provide the employee with a death benefit based on the substantive agreement with the employee. The Company has two split-dollar life insurance arrangements currently in effect that fall under this pronouncement, and as a result recorded a \$178,000 cumulative effect adjustment to retained earnings during the first quarter of 2008.

Total shareholders’ equity (exclusive of unrealized gains (losses) on investment securities and derivatives) was \$42.8 million at September 30, 2008 compared with \$40.8 million at December 31, 2007, an increase of \$2.2 million or 5%.

Net Income

We earned net income of \$2,153,000 for the nine months ended September 30, 2008, an increase of \$150,000 or 7% over the \$2,003,000 reported for the same period in 2007. We earned net income of \$717,000 for the three-month period ended September 30, 2008, an increase of \$107,000 or 18% over the \$610,000 reported for the same period in 2007. A discussion of the individual components making up net income follows.

Net Interest Income

Net interest income is our principal source of earnings and is calculated as the amount which loan and investment (earning assets) income exceeds the interest expense on deposits and borrowings (interest-bearing liabilities). Changes in the volume and mix of earning assets and interest-bearing liabilities, as well as their respective yields and rates, have a significant impact on the level of net interest income.

Total interest income amounted to \$27,240,000 for the nine months ended September 20, 2008, a decrease of 7% over the \$29,218,000 reported for the same period in 2007. Total interest income was \$8,986,000 for the three months ended September 2008, a decrease of 10% over the \$9,984,000 reported for the three months ended September 30, 2007. The decline in interest income for both periods is due to the significant reduction in the fed funds rate during 2008.

Total interest expense was \$14,601,000 for the nine months ended September 20, 2008, a decrease of 17% over the \$17,573,000 reported for the same period in 2007. Total interest expense was \$4,696,000 for the three months ended September 30, 2008, a decrease of 22% over the \$6,024,000 reported for the three months ended September 30, 2007. The decline in interest expense for both periods is due to the significant reduction in the fed funds rate during 2008.

As a result of the above, net interest income was \$12,639,000 for the nine months ended September 30, 2008, an increase of \$994,000 or 9% from the \$11,645,000 reported for the same period in 2007. Net interest income was \$4,290,000 for the three months ended September 30, 2008, an increase of \$330,000 or 8% from the \$3,960,000 reported for the same period in 2007. Our net interest margin was 2.89% for the nine months ended September 30, 2008, up 4 basis points compared to the 2.85% reported for the same period last year. Our net interest margin was 2.85% for the three months ended September 30, 2008, an increase of 1 basis point compared to the 2.84% reported for the same period last year. We are quite pleased with the positive movement in our net interest margin during this period of considerable pressure due to the significant reduction in the fed funds rate during 2008 as well as increased intense competition for deposits.

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Many of our competitors are struggling to meet funding and liquidity needs and, as a result, continue to raise deposits at inflated costs, despite the declining interest rate environment.

Interest Rate Risk

Interest rate risk is the risk to earnings or capital generated by the effects of changes in interest rates on our on- and off-balance sheet positions, and can take one or more of several forms:

- Repricing risk comes from timing mismatches in the ability to alter contractual rates earned on financial assets held or paid on interest-bearing liabilities.
- Basis risk refers to changes in the underlying relationships between market rates or indices, which result in a narrowing of the spread earned on a loan or investment relative to its cost of funds.
- Option risk arises from “embedded options” in many financial instruments such as:
 - interest rate options,
 - loan prepayment options,
 - deposit early withdrawal options,
 - callable Federal Home Loan Bank advances, and
 - prepayment of the underlying collateral of asset-backed securities.

Embedded options are complex risk positions that are difficult to predict and offset, and are a large component of our overall interest rate risk.

We have established risk measures, limits, policy guidelines and internal control mechanisms for managing our overall asset/liability management (“ALM”) position. The responsibility for interest rate risk control resides with management, with oversight by the board of directors and the ALCO Oversight Committee. We seek to balance the return potential of the ALM position against the desire to limit volatility in earnings.

At least quarterly, we measure the ALM position using earnings simulation modeling to estimate what assets and liabilities would re-price, and to what extent, within a one-year period in response to an immediate 200 and 100 basis point change in the Prime Rate, as well as in response to more gradual interest rate change. Our objective is to keep the change in net interest income over twelve months at or below 5%, and the change in net income at or below 10%, under an immediate 200 basis point interest rate shock scenario.

The model also incorporates management’s forecasts for balance sheet growth, noninterest income and noninterest expense. The interest rate scenarios are used for analytical purposes and do not necessarily represent management’s view of future market movements. Rather, these are intended to provide a measure of the degree of volatility interest rate movements may apply to our earnings. Modeling the sensitivity of earnings to interest rate risk is highly dependent on numerous assumptions embedded in the simulation model. While the earnings sensitivity analysis incorporates management’s best estimate of interest rate and balance sheet dynamics under various market rate movements, the actual behavior and resulting earnings impact likely will differ from that projected. Our cumulative repricing gap for the 90-day time period indicates an asset-sensitive position as of June 30, 2008 (the most recent date for which information is currently available).

We also estimate interest sensitivity by calculating the net present value of the balance sheet’s cash flows or the residual value of future cash flows ultimately due to shareholders. This calculation is known as Economic Value of Equity or “EVE” and is generally considered a better measure of long-term interest sensitivity than is IRS. Our objective is for the result to change 25% or less in an immediate 300 basis point

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interest rate shock scenario; 20% or less in an immediate 200 basis point interest rate shock scenario; and 15% or less in an immediate 100 basis point interest rate shock scenario.

Derivative Financial Instruments

For asset/liability management purposes, we may use interest rate swap agreements to hedge interest rate risk exposure to declining rates. Such derivatives are used as part of the asset/liability management process and are linked to specific assets, and have a high correlation between the contract and the underlying item being hedged, both at inception and throughout the hedge period.

Noninterest Income

Noninterest income for the three months ended September 30, 2008 and 2007 is shown in the following table:

	Noninterest Income (dollars in thousands)		
	3 months Ended 9/30/08	3 months Ended 9/30/07	% Increase/ (Decrease)
Service charges on deposits	\$ 288	\$ 284	1%
Income earned on bank owned life insurance	143	131	9%
Gains/(losses) on disposal of equipment	(4)	(4)	0%
Other income	245	158	55%
Total noninterest income	\$ 672	\$ 569	18%

Noninterest income for the nine months ended September 30, 2008 and 2007 is as follows:

	Noninterest Income (dollars in thousands)		
	9 months Ended 9/30/08	9 months Ended 9/30/07	% Increase/ (Decrease)
Service charges on deposits	\$ 839	\$ 889	(6)%
Income earned on bank owned life insurance	421	388	9%
Realized derivatives gains/(losses)	—	51	(100)%
Realized securities gains/(losses)	(14)	(50)	72%
Gains/(losses) on disposal of equipment	(6)	(4)	(50)%
Other income	626	495	26%
Total noninterest income	\$ 1,866	\$ 1,769	5%

As can be seen from the tables above, we experienced an increase in our noninterest income of 18% quarter over quarter and 5% for the nine months ended September 30, 2008 as compared to the same period last year. The increase in both instances is primarily due to the recording of \$131,000 in letter of credit fee

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income, which is included in other income, in the 3rd quarter of 2008, a 201% increase over the same time span in 2007. Previously the Bank recorded this income as it was collected as opposed to recognizing the income as the letter of credit was renewed. However we changed our billing and collection process in July and have aggressively pursued and collected past due letter of credit fees. At the same time, we wrote off stale fees deemed to be uncollectible.

Service charges on deposit accounts consist of a variety of charges imposed on demand deposits, interest-bearing deposits and savings deposit accounts. These include, but are not limited to, the following:

- Demand deposit monthly activity fees
- Service charges for checks for which there are non-sufficient funds or overdraft charges
- ATM transaction fees
- Debit card transaction fees

The principal factors that may affect current or future income for service charges on deposit accounts are:

- Internally generated growth
- Acquisitions of other banks/branches or de novo branches
- Adjustments to service charge structures

Other fee income consists of several categories, primarily the following:

- Fees for the issuance of official checks
- Fees for letters of credit
- Fees for wire transfers
- Safe deposit box rent
- Income from the sale of customer checks
- Income on real estate loans
- Extension fees, insurance premiums, and letter of credit fees
- Income earned from Valley Wealth Management, Inc.

Levels of income derived from these categories vary. For example, general market conditions and new insurance premiums purchased affect the income earned on bank owned life insurance. Fees for the issuance of official checks and customer check sales tend to grow as new branches are added. Fee schedules, while subject to change, generally do not alone yield a significant or discernable increase in income when they change.

Noninterest Expense

Noninterest expense for the three-month period ended September 30, 2008 and 2007 is shown in the following table:

Noninterest Expense
(dollars in thousands)

	3 months Ended 9/30/08	3 months Ended 9/30/07	% Increase/ (Decrease)	
Compensation expense	\$ 1,863	1,592		17%
Occupancy expense	227	180		26%
Equipment expense		159	131	21%
Data processing expense		189	182	4%
Advertising and marketing expense		84	65	29%
Insurance expense		97	90	8%
Audit fees		63	85	(26)%
Legal fees		90	70	29%
Franchise tax expense		100	85	18%
Business manager expense		71	64	11%
Deposit expense		79	56	41%
Loan expense		60	50	20%
Computer software expense		112	94	19%
Other expense		346	350	(1)%
Total noninterest expense		<u>\$3,540</u>	<u>3,094</u>	<u>14%</u>

In total, our noninterest expenses have increased by \$446,000 or 14% for the three-months ended September 30, 2008 as compared to the three-months ended September 30, 2007.

- Our compensation expense has increased due to the officer merit increases that were effective January 1, 2008 as well as the addition of several new lending related positions during the first half of this year and the addition of our Director of Internal Audit in late 2007.
- Occupancy and equipment expenses have increased primarily due to the renovation of the 5th floor of our main headquarters. We took occupancy of this floor in February 2008. We also opened our new full-service branch office in South Roanoke in September 2008. The full impact of this opening on occupancy and equipment expense will be seen beginning in the 4th quarter of 2008.
- Advertising and marketing expenses are up due to the television and radio advertising campaign for our new checking account product, My LifeStyle Checking.
- Our legal fees have increased this quarter due to work performed on our employee benefit plans to bring them into compliance with IRS Rule 409A as well as work performed in relation to the resolution of our problem assets.
- Contributing to the increase in our deposit expense was an \$8,800 loss on two fraudulent checks discovered by bank personnel in the 3rd quarter. Additionally, we incurred approximately \$5,000 in new expenses relating to our new checking product and approximately \$2,000 related to participation in the CDARS network.
- The increase in loan expense is related to the Special Assets consultant we hired during the first quarter of 2008 to assist with the work-out of our problem assets.
- Computer software expenses have increased primarily due to software costs associated with My LifeStyle checking, as well as costs associated with a new loan documentation system.
- We had experienced significant decreases in our audit fees as a result of the movement of our internal audit function from an outsourced environment to internal at the end of 2007.

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Noninterest expense for the nine months ended September 30, 2008 and 2007 is as follows:

Noninterest Expense (dollars in thousands)

	9 months Ended 9/30/08	9 months Ended 9/30/07	% Increase/ (Decrease)
Compensation expense	\$ 5,453	\$ 4,875	12%
Occupancy expense	666	560	19%
Equipment expense	483	409	18%
Data processing expense	601	493	22%
Advertising and marketing expense	386	221	75%
Insurance expense	306	259	18%
Audit fees	184	273	(33)%
Legal fees	166	150	11%
Franchise tax expense	301	254	19%
Business manager expense	166	215	(23)%
Deposit expense	189	184	3%
Loan expense	152	126	21%
Computer software expense	336	260	29%
Other expense	1,021	1,062	(4)%
Total noninterest expense	\$10,410	\$ 9,341	11%

In total, our noninterest expenses have increased by \$1,069,000 or 11% over the same period last year. We have experienced a number of increases and decreases in the various categories year-to-date, due to the same activities described above for quarter-over-quarter increases. In addition to the items mentioned above, we have reported larger increases in data processing year-over-year due to the conversion to an imaged environment during the 3rd quarter of 2007. Our business manager program has seen a decline in number of customers in 2008 as compared to 2007 and as a result, expenses associated with the program have declined year over year. Finally, the increase in our franchise tax expense is due to the increase in deposits.

Noninterest expenses are expected to continue to increase as a direct result of business growth, expansion, and complexity of banking operations as well as compliance with the Sarbanes-Oxley Act, which imposes additional management and reporting burdens on reporting companies such as this one.

Income Taxes

To reflect our anticipated federal income tax liability, an expense of \$828,000 effective tax rate of 27.8% was recognized for the nine months ended September 30, 2008, compared to an expense of \$746,000 at an effective tax rate of 27.1% recognized for the nine months ended September 30, 2007. The provision for income taxes for the third quarter of 2008 was \$270,000 at an effective tax rate of 27.4%, as compared to \$343,000 at an effective tax rate of 36.0% for the third quarter of 2007. During the third quarter of 2007, we recognized an \$84,000 “true-up” to our tax provision based on our 2006 tax return. This expense was related to correcting the valuation on two federal tax credits taken during the 2nd quarter 2007 and 4th quarter 2006.

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Without this “true-up”, our effective tax rate for the third quarter of 2007 would have been 27.2%. Additionally, factors contributing to the difference between the effective tax rate and the statutory rate of 34% include provision for loan loss reserves not allowed for tax purposes, tax-exempt interest income on municipal securities (net of disallowance), interest income on non-performing assets, and purchased tax credits carried forward and tax-exempt income earned on bank-owned life insurance.

Investment Securities

Our investment portfolio is used both for investment income and liquidity purposes. At this time, we do not invest in derivatives or other types of high-risk securities. Unrealized gains and losses on securities available-for-sale are recognized as direct increases or decreases in net shareholders' equity. Funds not used for capital expenditures or lending activities are invested in the following:

- Securities of the U.S. Government and its agencies
 - Treasury notes
 - Callable agency bonds
 - Noncallable agency bonds
- Mortgage-backed securities and collateralized mortgage obligations
 - Pools issued by government agencies
 - AAA rated corporate mortgage pools
- Municipal bonds
 - Taxable general obligation and revenue issues
 - Tax-exempt general obligation and revenue issues
- Investment grade corporate bonds
- Restricted equity securities
 - Federal Reserve Bank of Richmond shares
 - Federal Home Loan Bank of Atlanta shares
 - Community Bankers Bank shares

Investment securities (available for sale and held to maturity), including restricted equity securities, at September 30, 2008 were \$86.2 million, an increase of \$5.1 million or 6% from their level of \$81.1 million on December 31, 2007. See Note 3 to the Consolidated Financial Statements.

Loan Portfolio

Our total loans were \$514.3 million at September 30, 2008, an increase of \$27.1 million or 6% from the \$487.2 million reported at December 31, 2007. Our ratio of total loans to total funding sources (customer deposits, securities sold under agreements to repurchase, federal funds purchased, Federal Home Loan Bank advances, and guaranteed preferred beneficial interests in the Company's junior subordinated debentures) stood at 87.6% at September 30, 2008 and 88.0% at December 31, 2007. Management seeks to maintain the ratio of loans to funding sources at a maximum of 90%.

The loan portfolio primarily consists of commercial, real estate (including real estate term loans, construction loans and other loans secured by real estate) and loans to individuals for household, family and other consumer purposes. We adjust the mix of lending and the terms of our loan programs according to economic and market conditions, asset/liability management considerations and other factors. Loans typically (in excess of 90%) are made to businesses and individuals located within our primary and secondary market area, most of whom maintain deposit accounts with the Bank. There is no concentration of loans exceeding 10% of total loans, which is not disclosed in the Consolidated Financial Statements and the Notes

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to the Consolidated Financial Statements or discussed below.

The following table summarizes the loan portfolio by category, net of deferred fees, as of September 30, 2008 and 2007 and December 31, 2007:

Loan Portfolio Summary (dollars in thousands)

	9/30/08		12/31/07		9/30/07	
	\$	%	\$	%	\$	%
Commercial	90,038	17.5	87,551	18.0	85,933	17.6
Commercial real estate	192,752	37.5	170,599	35.0	176,264	36.1
Real estate construction	99,005	19.2	106,195	21.8	101,651	20.8
Residential real estate	126,794	24.7	115,458	23.7	116,667	23.9
Loans to individuals (except those secured by real estate)	5,728	1.1	7,361	1.5	7,337	1.6
Total loans	<u>514,317</u>	<u>100.0</u>	<u>487,164</u>	<u>100.0</u>	<u>487,852</u>	<u>100.0</u>

Loan Category Analysis

Commercial Loans. Commercial loans generally are made to provide operating lines of credit, to finance the purchase of inventory or equipment, and for other business purposes. The credit worthiness of the borrower is analyzed and re-evaluated on a periodic basis. Most commercial loans are collateralized with business assets such as accounts receivable, inventory and equipment. Even with substantial collateral, such as all the assets of the business and personal guarantees, commercial lending involves considerable risk of loss in the event of a business downturn or failure of the business.

Commercial Real Estate Loans. Commercial real estate construction and commercial real estate mortgages represent interim and permanent financing of commercial properties that are secured by real estate.

Real Estate Construction Loans. Real estate construction loans represent interim financing on residential and commercial properties under construction, and are secured by real estate. Once construction is completed and the loan becomes permanent, the loans are reclassified as either commercial real estate loans, which are secured by commercial property or residential real estate loans, which are secured by first deeds of trust.

Residential Real Estate Loans. Residential real estate loans are secured by first deeds of trust on 1-4 family residential properties. To mitigate interest rate risk, the Company usually limits the final maturity of residential real estate loans held for its own portfolio to 15-20 years, although exceptions are made for competitive reasons and under special programs. Residential real estate lending involves risk elements when there is lack of timely payment and/or a decline in the value of the collateral.

Loans to Individuals. Loans to individuals include installment loans, home equity lines of credit, and loans secured by junior liens on residential real estate. The loan proceeds typically are used to purchase vehicles, finance home remodeling, higher education, or for other consumer purposes.

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Asset Quality

Summary of Allowance for Loan Losses

The allowance for loan losses represents an amount that, in our judgment, will be adequate to absorb any losses on existing loans that may become uncollectible, although there can be no assurance that this will be so. The provision for loan losses increases the allowance, and loans charged off (net of recoveries) reduce the allowance.

In recognition of our estimate of inherent risks associated with lending activities, a provision for loan losses of \$1,114,000 was recorded during the nine months ended September 30, 2008, a decrease of \$210,000 or 16% in comparison to the \$1,324,000 reported during the same period in 2007. Net charge-offs for the nine-month period ended September 30, 2008 were \$619,000 as compared to \$1,614,000 for the nine-month period ended September 30, 2007, a decrease of \$995,000 or 62%. The ratio of the allowance for loan losses to total loans outstanding was approximately 1.05% at September 30, 2008, which compares to approximately 1.00% of gross loans at December 31, 2007 (see Note 4 to the Consolidated Financial Statements). These estimates are primarily based on our historical loss experience, portfolio concentrations, evaluation of individual loans and economic conditions.

A provision for loan losses of \$435,000 was provided during the three months ended September 30, 2008, a decrease of \$47,000 or 10% over the \$482,000 reported during the same period in 2007. Net charge-offs for the quarter ended September 30, 2008 were \$75,000 as compared to \$1,167,000 for the same period last year, a decrease of \$1,092,000 or 94%. Included in our provision for the third quarter of 2008 are specific reserves of \$261,000 on our impaired assets and \$174,000 in additional general reserves due to the declining economic environment. We continue to be concerned about the general slowdown in economic activity and the overall weakness in the residential real estate market. However, we are confident in our ability to navigate through the effects of the current economic and financial environment.

We regularly review asset quality and re-evaluate the allowance for loan losses. However, no assurance can be given that unforeseen adverse economic conditions or other circumstances will not result in increased provisions in the future. Additionally, regulatory examiners may require us to recognize additions to the allowance based upon their judgment about the loan portfolio and other information available to them at the time of their examinations. (See "Allowance for Loan Losses" under "Critical Accounting Policies".)

Nonperforming Assets and Impaired Loans

Nonperforming Assets. Nonperforming assets include nonaccrual loans, loans past due 90 days or more, restructured loans and foreclosed/repossessed property. A loan will be placed on nonaccrual status when collection of all principal or interest is deemed unlikely. A loan will automatically be placed on nonaccrual status when principal or interest is past due 90 days or more, unless the loan is both well secured and in the process of being collected. In this case, the loan will continue to accrue interest despite its past due status.

A restructured loan is a loan in which the original contract terms have been modified due to a borrower's financial condition or there has been a transfer of assets in full or partial satisfaction of the loan. A modification of original contractual terms is generally a concession to a borrower that a lending institution

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would not normally consider.

An impaired loan as defined in SFAS 114 is a loan when, based on current information and events, it is likely that a lending institution will be unable to collect all amounts, including both principal and interest, due according to the contractual terms of the loan agreement.

Our non-performing asset ratio is well below our peers and has improved significantly as compared to September 30, 2007. As of September 30, 2008, total non-performing assets amounted to \$2,170,000 or 0.34% of total assets, compared to \$8,271,000, or 1.38% of total assets as of September 30, 2007, representing a \$6,101,000 or 74% decrease year over year. Our loans past due more than 90 days as a percentage of total loans were at 0.00% at September 30, 2008 and December 31, 2007. Our foreclosed, repossessed and idled properties was at \$500,000 at September 30, 2008, an increase of \$55,000 from December 31, 2007, but a substantial decrease of \$836,000 as compared to June 30, 2008. The decrease is attributable to the following:

- Foreclosure on a spec house with a market value of approximately \$279,000 was sold in the third quarter with a slight loss taken.
- Foreclosure on a residential house with a fair market value of approximately \$296,000 was sold in the third quarter with a slight gain taken.
- Five (of a total of 15) lots were sold in a residential community that was foreclosed on in the 4th quarter of 2007. The value of this transaction was \$199,000.
- We wrote down the values of the foreclosed, repossessed and idled properties still owned by the bank as of September 30, 2008 by \$74,000 in the third quarter to reflect the most current approximate fair market values.

A total of \$477,000 in specific reserves is included in the balance of the allowance for loan losses as of September 30, 2008 for impaired loans, which compares to a total of \$673,000 as of December 31, 2007 and \$1,056,000 as of September 30, 2007. Although we presently believe any potential loss exposure has been fully reserved for our impaired loans at September 30, 2008 and the remaining balances are secured by customer assets pledged as collateral, it is obviously a situation which can change, which we are constantly monitoring.

Nonperforming assets at September 30, 2008, December 31, 2007 and September 30, 2007 are presented in the following table:

Nonperforming Assets (dollars in thousands)

	<u>9/30/08</u>	<u>12/31/07</u>	<u>9/30/07</u>
Nonaccrual loans	\$1,669	\$ 7,029	\$8,271
Loans past due 90 days or more	—	—	—
Restructured loans	—	—	—
Total nonperforming loans	\$1,669	\$ 7,029	\$8,271
Foreclosed, repossessed and idled properties	500	445	—
Total nonperforming assets	<u>\$2,169</u>	<u>\$ 7,474</u>	<u>\$8,271</u>

Each quarter, the Directors' Loan Committee, composed of eight directors, reviews all loans on our watch list to determine proper action and reporting of any loans identified as substandard by the credit quality review. We believe that the above allocated reserves are appropriate for the impaired loans in our portfolio

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based upon a detailed review of the quality and pledged collateral of each individual loans considered impaired at each of the above-referenced periods. (See “Critical Accounting Policies”.)

If nonaccrual loans had performed in accordance with their original terms, additional interest income in the amount of \$151,000 for the nine-month period ended September 30, 2008; \$910,000 for the year ended December 31, 2007; and \$704,000 for the nine-month period ended September 30, 2007 would have been recorded.

Other Assets

We have purchased life insurance contracts on key employees, the tax-exempt income from which is the funding vehicle for the Company’s Supplemental Executive Retirement Plan (“SERP”) and other employee benefit costs including health insurance, dental insurance, life insurance, and 401(k) employer match. Bank owned life insurance was \$12,260,000 at September 30, 2008 an increase of \$621,000 over the \$11,639,000 reported as of December 31, 2007. The increase is due to the \$421,000 increase in the cash surrender value of the life insurance contracts and a \$200,000 purchase of additional life insurance on one of our key executives.

Deposits

The levels and mix of deposits are influenced by such factors as customer service, interest rates paid, service charges and the convenience of banking locations. Competition for deposits is intense from other depository institutions and money market funds, some of which offer interest rates higher than we pay. We attempt to identify and implement pricing and marketing strategies designed to control the overall cost of deposits and to maintain a stable deposit mix.

The following table summarizes our total deposits at September 30, 2008 and December 31, 2007:

Deposit Summary (dollars in thousands)

	9/30/08		12/31/07		Increase/(Decrease)	
	\$	%	\$	%	\$	%
Time deposits	273,162	59.1	263,941	61.0	9,221	3.5
Interest bearing demand & money market	112,197	24.3	100,840	23.3	11,357	11.3
Savings	58,227	12.6	51,310	11.9	6,917	13.5
Total interest bearing deposits	443,586	96.0	416,091	96.2	27,495	6.6
Noninterest demand & official checks	18,345	4.0	16,362	3.8	1,983	12.1
Total deposits	<u>461,931</u>	<u>100.0</u>	<u>432,453</u>	<u>100.0</u>	<u>29,478</u>	<u>6.8</u>

We would prefer to have transaction accounts comprise a larger percentage of total deposits, but in order to fund our loan growth we often have to rely on higher-cost certificates of deposit. Within the certificate of deposit category, in the past, we have marketed CDs nationally to institutional depositors, primarily banks, thrift institutions and credit unions, through an Internet-based rate posting service. National market CDs at September 30, 2008 were \$4.7 million and represent 1.7% of total CDs and 1.0% of total deposits at September 30, 2008.

We continue to experience strong core deposit growth from customers who prefer dealing with a

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local, established community bank. Our Prime Money Market account, which has an interest rate tied to the Wall Street Journal Prime rate, continues to attract customers and has accumulated over \$90 million in deposits as of the end of the third quarter of 2008, an increase of 25% over the same period last year. Additionally, we are very pleased with the results of our new checking account product, MyLifeStyle Checking, launched earlier this year. Both of these products have been instrumental in the execution of our strategy to reduce our overall reliance on certificates of deposits.

Short-Term Borrowings

Total short-term borrowings (including federal funds purchased and securities sold under agreements to repurchase) decreased by \$2.2 million from their level of \$49.6 million at December 31, 2007 to a total of \$47.4 million as of September 30, 2008. The decrease is due to a \$0 federal funds purchased position at September 30, 2008 as compared to the \$3.3 million federal funds purchased position at December 31, 2007. Conversely, our commercial sweep account program has experienced a \$2.1 million increase since December 31, 2007. Short-term borrowings at September 30, 2008 include Federal Home Loan Bank of Atlanta (“FHLB”) borrowings in the amount of \$12.0 million and a commercial sweep account program in the amount of \$35.4 million.

The FHLB borrowings include two fixed rate credits. The first loan is a \$5 million fixed rate credit at 4.4975% that matures on October 31, 2008 and the second FHLB borrowing is a \$7 million fixed rate credit at 2.675% that matures on November 12, 2008.

The commercial sweep program involves balances subject to repurchase agreements which are reported as short term borrowings rather than deposits since they are not FDIC insured. The balance in the program is \$35.4 million at September 30, 2008, an increase of \$2.1 million from the \$33.3 million level at December 31, 2007. The program consists of a demand deposit account from which we invest available balances daily in securities on an overnight basis subject to repurchase. On the following business day, we repurchase from the customer the securities for an amount equal to the amount of available balances invested in the securities. Interest is calculated daily at the rate applicable for each overnight period; however, it is posted to the customer accounts only once per month.

Long-Term Borrowings

Federal Home Loan Bank advances are relatively cost-effective funding sources and provide us with the flexibility to structure borrowings in a manner that aids in the management of interest rate risk and liquidity. Long-term convertible Federal Home Loan Bank advances totaled \$68.0 million at September 30, 2008 and \$55.0 million at December 31, 2007. (See Footnote 9 of the Company’s Consolidated Financial Statements for more information on the long-term advances.)

Guaranteed Preferred Beneficial Interests in the Company’s Junior Subordinated Debentures

Valley Financial Statutory Trust III, a statutory business trust (“Trust III”) was created by the Company on December 15, 2006, at which time Trust III issued \$5 million in aggregate liquidation amount of \$1 par value preferred capital trust securities which mature January 30, 2037. Distributions are payable on the securities at a floating rate equal to the 3-month LIBOR plus 1.73%, and the securities may be prepaid at par by Trust III at any time after January 20, 2012. The principal assets of Trust III are \$5.2 million of the Company’s junior subordinated debentures which mature on January 30, 2037, and bear interest at a floating

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rate equal to the 3-month LIBOR plus 1.73%, and which are callable by the Company after January 30, 2012. All \$155,000 in aggregation liquidation amount of Trust III's common securities are held by the Company.

Valley Financial (VA) Statutory Trust II, a statutory business trust ("Trust II"), was created on September 26, 2005, at which time Trust II issued \$7.0 million in aggregate liquidation amount of \$1 par value preferred capital trust securities which mature December 15, 2035. Distributions are payable on the securities at a floating rate equal to the 3-month LIBOR plus 1.49%, and the securities may be prepaid at par by Trust II at any time after December 15, 2010. The principal assets of Trust II are \$7.2 million of the Company's junior subordinated debentures which mature on December 15, 2035, and bear interest at a floating rate equal to the 3-month LIBOR plus 1.49%, and which are callable by the Company after December 15, 2010. All \$217,000 in aggregation liquidation amount of Trust II's common securities are held by the Company.

Valley Financial (VA) Statutory Trust I, a statutory business trust ("Trust I"), was created on June 26, 2003, at which time the Trust issued \$4.0 million in aggregate liquidation amount of \$1 par value preferred capital trust securities which mature June 26, 2033. Distributions are payable on the securities at a floating rate equal to the 3-month LIBOR plus 3.10%, capped at 11.75%, and the securities may be prepaid at par by Trust I at any time after June 26, 2008. The principal assets of Trust I are \$4.1 million of the Company's junior subordinated debentures which mature on June 26, 2033, and bear interest at a floating rate equal to the 3-month LIBOR plus 3.10%, capped at 11.75%, and which are callable by the Company after June 26, 2008. All \$124,000 in aggregation liquidation amount of Trust I's common securities are held by the Company.

The debenture proceeds from Trust I, Trust II, and Trust III are included in our Tier 1 capital for regulatory capital adequacy purposes to the extent that they do not exceed 25% of our total Tier 1 capital including the securities. Of the total \$16,000,000 in trust preferred proceeds from all three trusts, \$14,280,000 is included in Tier 1 capital at September 30, 2008. The remaining \$1,720,000 is included in Tier 2 capital at September 30, 2008. Our obligations with respect to the issuance of Trust I, Trust II and Trust III's preferred securities and common securities constitute a full and unconditional guarantee of Trust I, Trust II and Trust III's obligations with respect to the preferred securities and common securities. Subject to certain exceptions and limitations, we may elect from time to time to defer interest payments on our junior subordinated debentures, which would result in a deferral of distribution payments on Trust I, Trust II and Trust III's preferred trust securities and common securities.

Capital Adequacy

We seek to maintain a capital structure adequate to support anticipated asset growth and serve as a cushion to absorb potential losses. Our financial position at September 30, 2008 reflects liquidity and capital levels currently adequate to fund anticipated near-term business expansion. We review the adequacy of our capital on an ongoing basis at the Company and Bank level and are committed to maintaining a total risk based capital ratio of 10% or greater at the Bank level, as is required for a "well capitalized" institution.

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For the periods indicated, the Company had the following risk-based capital and leverage ratios:

Valley Financial Corporation

<u>Ratio</u>	<u>Well Capitalized</u>	<u>9/30/08</u>	<u>12/31/07</u>	<u>9/30/07</u>
Tier 1	6.0%	10.7%	10.7%	9.9%
Total	10.0%	12.0%	12.1%	11.6%
Leverage	5.0%	9.0%	9.1%	8.5%

For the periods indicated, the Bank had the following risk-based capital and leverage ratios:

Valley Bank

<u>Ratio</u>	<u>Well Capitalized</u>	<u>9/30/08</u>	<u>12/31/07</u>	<u>9/30/07</u>
Tier 1	6.0%	9.6%	9.6%	9.4%
Total	10.0%	10.6%	10.6%	10.5%
Leverage	5.0%	8.1%	8.2%	8.1%

The Company paid its ninth consecutive semi-annual cash dividend on the Company's common stock, in the amount of \$0.07 per share on July 1, 2008 to shareholders of record May 30, 2008.

Liquidity

Asset/liability management activities are designed to ensure that adequate liquidity is available to meet loan demand or deposit outflows and, through the management of our interest sensitivity position, to manage the impact of interest rate fluctuations on net interest income.

Liquidity measures our ability to meet our maturing obligations and existing commitments, to withstand fluctuations in deposit levels, to fund our operations and to provide for customers' credit needs. Liquidity represents a financial institution's ability to meet present and future financial obligations through either the sale or maturity of existing assets or the acquisition of additional funds from alternative funding sources.

Liquid assets, which include cash and due from banks, federal funds sold, interest-bearing deposits at other banks and non-pledged securities available-for-sale, at September 30, 2008, totaled \$22.4 million compared to \$20.0 million at December 31, 2007. Our funding sources consist of an established federal funds line with a regional correspondent bank totaling \$12.0 million that had a \$0 balance as of September 30, 2008, three established federal funds lines with third party banks totaling \$23.0 million that had a outstanding balances totaling \$0 as of September 30, 2008, and an established line with the FHLB that had \$80.0 million outstanding under a total line of \$92.6 million as of September 30, 2008. We believe these

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arrangements will be renewed at maturity.

We sell excess funds as overnight federal funds sold to provide an immediate source of liquidity. We had federal funds sold of \$12.4 million at September 30, 2008 and \$0 at December 31, 2007.

As a result of our management of liquid assets and our ability to generate liquidity through alternative funding sources, we believe we maintain overall liquidity sufficient to meet our depositors' requirements and satisfy our customers' credit needs.

Recent and Future Accounting Considerations

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations," ("SFAS 141(R)") which replaces SFAS 141. SFAS 141(R) establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest; recognizes and measures goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. FAS 141(R) is effective for acquisitions by the Company taking place on or after January 1, 2009. Early adoption is prohibited. Accordingly, a calendar year-end company is required to record and disclose business combinations following existing accounting guidance until January 1, 2009. The Company will assess the impact of SFAS 141(R) if and when a future acquisition occurs.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51" ("SFAS 160"). SFAS 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Before this statement, limited guidance existed for reporting noncontrolling interests (minority interest). As a result, diversity in practice exists. In some cases minority interest is reported as a liability and in others it is reported in the mezzanine section between liabilities and equity. Specifically, SFAS 160 requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financial statements and separate from the parent's equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. SFAS 160 clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interests. SFAS 160 is effective for the Company on January 1, 2009. Earlier adoption is prohibited. The Company currently does not have any noncontrolling interests and therefore anticipates no immediate impact related to the adoption of SFAS 160.

In February 2008, the FASB issued FASB Staff Position No. 140-3, "Accounting for Transfers of Financial Assets and Repurchase Financing Transactions" ("FSP 140-3"). This FSP provides guidance on accounting for a transfer of a financial asset and the transferor's repurchase financing of the asset. This FSP presumes that an initial transfer of a financial asset and a repurchase financing are considered part of the same arrangement (linked transaction) under SFAS No. 140. However, if certain criteria are met, the initial transfer and repurchase financing are not evaluated as a linked transaction and are evaluated separately under Statement 140. FSP 140-3 will be effective for financial statements issued for fiscal years beginning after November 15, 2008, and interim periods within those fiscal years and earlier application is not permitted.

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Accordingly, this FSP is effective for the Company on January 1, 2009. The Company is currently evaluating the impact, if any, the adoption of FSP 140-3 will have on its financial position, results of operations and cash flows.

In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133” (“SFAS 161”). This Statement changes the disclosure requirements for derivative instruments and hedging activities. Specifically, SFAS 161 requires entities to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This Statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Company currently does not hold any derivative instruments and therefore anticipates no immediate impact related to the adoption of SFAS 161.

In April 2008, the FASB issued FASB Staff Position No. 142-3, “Determination of the Useful Life of Intangible Assets” (“FSP 142-3”). This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, “Goodwill and Other Intangible Assets”. The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R), “Business Combinations,” and other U.S. generally accepted accounting principles. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years and early adoption is prohibited. Accordingly, this FSP is effective for the Company on January 1, 2009. The Company does not believe the adoption of FSP 142-3 will have a material impact on its financial position, results of operations or cash flows.

In May, 2008, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standard (“SFAS”) No. 162, “The Hierarchy of Generally Accepted Accounting Principles,” (“SFAS No. 162”). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States (the GAAP hierarchy). SFAS No. 162 will be effective 60 days following the SEC’s approval of the Public Company Accounting Oversight Board’s amendments to AU Section 411, “The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles.” The FASB has stated that it does not expect SFAS No. 162 will result in a change in current practice. The application of SFAS No. 162 will have no effect on the Company’s financial position, results of operations or cash flows.

The FASB issued FASB Staff Position No. APB 14-1, “Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement),” (“FSP No. APB 14-1”). The Staff Position specifies that issuers of convertible debt instruments that may be settled in cash upon conversion should separately account for the liability and equity components in a manner that will reflect the entity’s nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. FSP No. APB 14-1 provides guidance for initial and subsequent measurement as well as derecognition provisions. The Staff Position is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is not permitted. The adoption of this

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Staff Position will have no material effect on the Company's financial position, results of operations or cash flows.

In June, 2008, the FASB issued FASB Staff Position No. EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities," ("FSP EITF 03-6-1"). The Staff Position provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents are participating securities and must be included in the earnings per share computation. FSP EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. All prior-period earnings per share data presented must be adjusted retrospectively. Early application is not permitted. The adoption of this Staff Position will have no material effect on the Company's financial position, results of operations or cash flows.

The SEC's Office of the Chief Accountant and the staff of the FASB issued press release 2008-234 on September 30, 2008 ("Press Release") to provide clarifications on fair value accounting. The press release includes guidance on the use of management's internal assumptions and the use of "market" quotes. It also reiterates the factors in SEC Staff Accounting Bulletin ("SAB") Topic 5M which should be considered when determining other-than-temporary impairment: the length of time and extent to which the market value has been less than cost; financial condition and near-term prospects of the issuer; and the intent and ability of the holder to retain its investment for a period of time sufficient to allow for any anticipated recovery in market value.

On October 10, 2008, the FASB issued FSP SFAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active" ("FSP SFAS 157-3"). This FSP clarifies the application of SFAS No. 157, "Fair Value Measurements" (see Note 13) in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that asset is not active. The FSP is effective upon issuance, including prior periods for which financial statements have not been issued. For the Company, this FSP is effective for the quarter ended September 30, 2008.

The Company considered the guidance in the Press Release and in FSP SFAS 157-3 when conducting its review for other-than-temporary impairment as of September 30, 2008 and determined that it did not result in a change to its impairment estimation techniques.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Not applicable.

Item 4. Controls and Procedures.

As of the end of the period covered by the report, an evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective. There have not been any changes in our internal control over financial reporting that occurred during the last quarter that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

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The design of any system of controls is based in part upon certain assumptions about the likelihood of future events. There can be no assurance that any design will succeed in achieving its stated goal under every potential condition, regardless of how remote. In addition, the operation of any system of controls and procedures is dependent upon the employees responsible for executing it. While we have evaluated the operation of our disclosure controls and procedures and found them effective, there can be no assurance that they will succeed in every instance to achieve their objective.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

There were no material pending legal proceedings, other than ordinary routine litigation incidental to the business, during the quarter.

Item 1A. Risk Factors.

Not applicable.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

There were no unregistered sales of equity securities during the quarter.

Item 3. Defaults Upon Senior Securities.

There were no defaults upon Senior Securities in the quarter.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

Item 5. Other Information.

On November 12, 2008, the Company and Mr. Ellis L. Gutshall, President and Chief Executive Officer, entered into an amended employment agreement with an effective date of November 1, 2008. The amendments to the agreement were designed to bring the agreement into written compliance with Section 409A of the Internal Revenue Code, as amended (the "Code") and Treasury Regulations thereunder. Code Section 409A-driven changes include a required six-month delay for payments made upon a separation from service, where the recipient is a key employee of a public company. Expense reimbursement provisions found in the agreement also contain new language to ensure that Code Section 409A's requirements are met. The agreement was also amended to include a simplified section on the parties' split dollar arrangement, which now simply says that the terms of that arrangement governs. The Good Reason definition was modified to reflect the intent that a Good Reason termination may occur prior to a Change in Control. Finally, language stating that the Employer will have any successor assume the obligations of the agreement is now mandatory. Previously, the Executive was required to request the Employer obtain such assurances. The agreement is filed herewith as Exhibit 10.1.

On November 12, 2008, the Company and Ms. Kimberly B. Snyder, Executive Vice President and Chief Financial Officer ("Employee"), entered into an employment agreement with an Effective Date of November 1, 2008. The material terms of the agreement provide for an initial 2-year term and provide that if the Employee's employment is terminated by the Company without cause or by the Employee with good reason (as these terms

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are defined in the agreement), the Company will make a severance payment to the Employee equal to the total base salary that the Employee would have earned had Employee continued in the Company's employ through the remaining term of the agreement, such base salary to be at the rate in effect at the time Notice of Termination is given. Such severance payment will be made on the first day of the month following the six-month anniversary of the Employee's date of termination. Additionally, the agreement provides that upon termination of Employee's employment within thirty-six (36) months following a change in control for reasons other than death, retirement, cause, disability, or good reason (as these terms are defined in the agreement), the Company shall pay to the Employee an amount equal to 2.99 multiplied by the Employee's annualized includable compensation for the base period (calculation defined in the agreement). The agreement also contains a 2-year non competition agreement if the Employee's employment is terminated by Employee other than for good reason or by Employer other than for cause. The agreement is filed herewith as Exhibit 10.2.

On November 12, 2008, Valley Bank ("Bank") and Ms. Kimberly B. Snyder, Executive Vice President and Chief Financial Officer ("Employee"), entered into a split-dollar insurance agreement with an effective date of November 1, 2008. The Bank has paid the entire premium of a life insurance policy ("Policy") on the life of the Employee and is the direct beneficiary of an amount equal to the death proceeds of the Policy less the Employee Proceeds (as hereinafter defined). The terms of the agreement provide that upon the death of the Employee, a payment shall be made to Employee's designated beneficiary or beneficiaries equal to three times the Employee's base salary during the last full year of Employee's employment with the Company ("Employee Proceeds") and the excess of the death proceeds paid to Valley Bank. In the event the total death proceeds are insufficient to pay the Employee Proceeds, the Company shall not be obligated to make up and pay the difference to Employee's designated beneficiary. The agreement shall terminate automatically upon termination of Employee's employment with either the Bank or the Company regardless of reason, cause or event except for (a) Employee's death; (b) Employee's Disability; or (c) Employee terminates employment for Good Reason (as defined in Employee's Employment agreement). The agreement is filed herewith as Exhibit 10.3.

On November 12, 2008, the Company entered into Change in Control Severance Agreements with the following Named Executive Officers: John T. McCaleb, Executive Vice President and Chief Lending Officer and Andrew M. Agee, Senior Vice President and Senior Real Estate Office. Each severance agreement provides that, if the executive's employment is terminated by the Company after a Change in Control without cause or by the employee with good reason (as these terms are defined in the agreement), the Company will make a severance payment to the executive equal to two times the executive's annual salary as then in effect. The agreements contain other terms, including a 2-year non competition agreement if the executive's employment is terminated by the executive other than for good reason or by Employer other than for cause. A form of the agreement is filed herewith as Exhibit 10.4.

The Company amended its Supplemental Executive Retirement Plan ("Plan") to consolidate administration and bring each existing plan into written compliance with Section 409A of the Internal Revenue Code, as amended (the "Code") and Treasury Regulations thereunder. Written Compliance is required by December 31, 2008. Code Section 409A-driven changes include minor revisions to the "Disabled" definition, and inclusion of a complaint definition of "Separation from Service". In addition, the plan now incorporates a required six-month delay for payments made to a key employee (defined in the Plan as a "specified employee") upon a separation from service. The effective date of the amended Plan is November 1, 2008.

Structural changes relating to the consolidation of individual plans include (i) a description of eligibility criteria; (ii) rewording to tie benefits to years of participation (as opposed to years since the effective date of an individual plan); (iii) using exhibits to set forth the particular vesting schedule applicable to each individual participant; and changing references in affected plan sections accordingly; (iv) using exhibits to set forth assumptions and factors for computation of each participant's benefit; and (v) the addition of plan amendment and termination provisions.

Changes designed to improve existing language include (i) more detail in the description of the Target Annual Accrual to match actual operations; (ii) rewording of the payment provisions for clarity; (iii) streamlined claims procedures language; and (iv) affirmative statements regarding the Administrator's fiduciary discretion to determine entitlement to benefits.

The Company entered into new Plan agreements reflecting the amendments described above with the following Named Executive Officers on November 12, 2008: Ellis L. Gutshall, President and Chief Executive Officer; Kimberly B. Snyder, Executive Vice President and Chief Financial Officer; John T. McCaleb, Executive Vice President and Chief Lending Officer; and Andrew M. Agee, Senior Vice President and Senior Real Estate Officer. A form of the Plan is filed hereto as Exhibit 10.5.

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Item 6. Exhibits

Exhibit Number	Description
10.1	Amended Employment Agreement between the Company and Mr. Ellis L. Gutshall, President and Chief Executive Officer.*
10.2	Employment Agreement between the Company and Ms. Kimberly B. Snyder, Executive Vice President and Chief Financial Officer.*
10.3	Split-Dollar Insurance Agreement between the Company and Ms. Kimberly B. Snyder, Executive Vice President and Chief Financial Officer.*
10.4	Form of Change in Control Severance Agreement between the Company and Mr. John T. McCaleb, Executive Vice President and Chief Lending Officer and Mr. Andrew B. Agee, Senior Vice President and Senior Real Estate Officer.*
10.5	Form of Amended Supplemental Retirement Plan between the Company and Mr. Ellis L. Gutshall, President and Chief Executive Officer; Ms. Kimberly B. Snyder, Executive Vice President and Chief Financial Officer; Mr. John T. McCaleb, Executive Vice President and Chief Lending Officer; and Mr. Andrew M. Agee, Senior Vice President and Senior Real Estate Officer.*
11.0	Statement re Computation of Earnings per Share (filed herewith as Footnote 5)*.
31.1	Chief Executive Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
31.2	Chief Financial Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
32.1	Chief Executive Officer Certification Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*
32.2	Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

* Filed herewith.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

November 13, 2008
Date

VALLEY FINANCIAL CORPORATION

/s/ Ellis L. Gutshall
Ellis L. Gutshall, President and Chief Executive Officer

November 13, 2008
Date

/s/ Kimberly B. Snyder
Kimberly B. Snyder, Executive Vice President and Chief Financial Officer

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EXHIBIT INDEX

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32.2	Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

* Filed herewith.

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Section 2: EX-10.1 (AMENDED EMPLOYMENT AGREEMENT)

Exhibit 10.1

EMPLOYMENT AGREEMENT BETWEEN VALLEY FINANCIAL CORPORATION AND ELLIS L. GUTSHALL

This Employment Agreement (“Agreement”), dated for purposes of identification September 21, 2000, and amended and restated effective November 1, 2008, is made and entered into between Valley Financial Corporation (“Employer”), a bank holding company owning all of the outstanding capital stock of Valley Bank (“Bank”) and Ellis L. Gutshall (“Employee”). This Agreement, as amended and restated, is intended to comply with the requirements of Section 409A of the Internal Revenue Code of 1986, as amended.

WHEREAS, Employer desires to employ Employee as President and Chief Executive Officer of the Employer and Bank; and

WHEREAS, Employee is willing to accept such positions with the Employer and Bank.

NOW, THEREFORE, in consideration of the premises and mutual covenants and agreements hereinafter set forth, the parties hereto agree as follows:

SECTION I. DEFINITIONS.

As used in this Agreement, the following capitalized terms have the indicated meanings unless the context clearly requires otherwise:

A. “Bank Board” means the Board of Directors of the Bank.

B. “Board” means the Board of Directors of the Employer.

C. “Cause” means (i) the willful and continued failure by Employee to substantially perform his duties hereunder (other than any such failure resulting from his incapacity due to physical or mental illness) after a written demand for substantial performance is delivered to the Employee by the Board (excluding Employee) and which failure has not been cured as hereinafter provided, which demand specifically identifies the manner in which the Board believes that Employee has not substantially performed his duties, or (ii) the willful engaging by the Employee in illegal conduct or any conduct which is demonstrably and materially injurious to the Employer or Bank. Without limiting the generality of the foregoing, Cause shall include the issuance of a removal order or similar order by a governmental regulatory agency with appropriate jurisdiction prohibiting Employee from participating in the affairs of the Employer or Bank. Any act or failure to act based upon authority given pursuant to a resolution

duly adopted by the Board or Bank Board or based upon the advice of counsel for the Employer or Bank shall be conclusively presumed to be done, or omitted to be done, by the Employee in good faith and in the best interests of the Employer and Bank. It is also expressly understood that the Employee's attention to matters not directly related to the business of the Employer or Bank shall not provide a basis for termination for Cause so long as the Employer and/or Bank has approved Employee's engagement in such activities. Upon the issuance of a written demand for substantial performance, Employee shall have a reasonable period of time in which to correct such alleged violation, provided, however, that the alleged violation is neither dishonest nor criminal. It is agreed that thirty (30) days shall be deemed a reasonable time in which to correct any such alleged violation. If the Employee is unable to correct the alleged violation within said thirty (30) day period, then if the Board (excluding Employee) determines that the Employee is using his best efforts to make such correction and that the alleged violation can be corrected, the Board shall extend the thirty (30) day period by such time as is reasonably necessary for the Employee to effect such correction as expeditiously as practicable. Notwithstanding the

foregoing, after a Change in Control of the Employer the Employee shall not be deemed to be terminated for Cause unless and until there shall have been delivered to Employee a copy of a resolution duly adopted by the affirmative vote of not less than 75% of the entire membership of the Board (excluding Employee) at a meeting of such Board called and held for such purpose (after a reasonable notice to Employee and an opportunity for Employee, together with his counsel, to be heard before the Board), finding that in the good faith opinion of the Board the Employee was guilty of conduct set forth above and specifying the particulars thereof in detail. In such event Employee shall have a reasonable period of time in which to correct the alleged violation, provided, however, that the alleged violation is neither dishonest nor criminal. As in the case of an alleged violation prior to a Change in Control, it is agreed that thirty (30) days (extended by the Board, if necessary, as outlined above) shall be deemed a reasonable time in which to correct any such alleged violation.

D. "Change in Control" or "Change in Control of the Employer" means a change in control of a nature that would be required to be reported (assuming such event has not been "previously reported") in response to Item I(a) of the Current Report on Form 8-K, as in effect on the date hereof, pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended ("Exchange Act"); provided that, notwithstanding the foregoing and without limitation, such a change in control shall be deemed to have occurred at such time as (i) any Person is or becomes the "beneficial owner" (as defined in Rule 13d-3 or Rule 13d-5 under the Exchange Act as in effect on January 1, 1994), directly or indirectly, of 20% or more of the combined voting power of the Employer's voting securities; (ii) the Incumbent Board ceases for any reason to constitute at least the majority of the Board, provided that any person becoming a director subsequent to the date hereof whose election, or nomination for election by the Employer's shareholders, was approved by a vote of at least 75% of the directors comprising the Incumbent Board (either by a specific vote or by approval of the proxy statement of the Employer in which such person is named as a nominee for director, without objection to such nomination) shall be, for purposes of this clause (ii) considered as though such person were a member of the Incumbent Board; (iii) all or substantially all of the assets of the Employer or the assets of the Bank are sold, transferred or conveyed by any means, including but not limited to direct purchase or merger, if the transferee is not controlled by the Employer, control meaning the ownership of more than 50% of the combined voting power of such entity's voting securities; or (iv) the Employer is merged or consolidated with another corporation or entity and as a result of such merger or consolidation less than 75% of the outstanding voting securities of the surviving or resulting corporation or entity shall be owned in the aggregate by the former shareholders of the Employer. Notwithstanding anything in the foregoing to the contrary, no change in control shall be deemed to have occurred for purposes of this Agreement by virtue of any transaction (i) which results in the Employee or a group of Persons which includes the Employee, acquiring, directly or indirectly, 20% or more of the combined voting power of the Employer's voting securities; (ii) arranged or caused by a federal bank regulatory agency possessing appropriate jurisdiction on the grounds of failing financial condition of the Employer or Bank which results in the acquisition, directly or indirectly, of 20% or more of the combined voting power of the Employer's voting securities by any Person or (iii) which results in the Employer, any subsidiary of the Employer or any profit-sharing plan, employee stock ownership plan or employee benefit plan of the Employer or any of its subsidiaries (or any trustee of or fiduciary with respect to any such plan acting in such capacity) acquiring, directly or indirectly, 20% or more of the combined voting power of the Employer's voting securities.

E. "Code" means the Internal Revenue Code of 1986, as amended from time to time.

F. "Date of Termination" means (i) if Employee's employment is terminated by Employee for other than Good Reason, ninety (90) days after Notice of Termination is given, (ii) if Employee's employment is to be terminated for Disability, thirty (30) days after Notice of Termination is given (provided that the Employee shall not have returned to the performance of his duties on a full-time basis during such thirty (30) day period), (iii) except as otherwise provided in this paragraph, if Employee's employment is to be terminated by the Employer for Cause or by the Employee for Good Reason, the date specified in the Notice of Termination, (iv) the date of Employee's death, or (v) if Employee's employment is to be terminated by the Employer for any reason other than

Cause or Disability, the date specified in the Notice of Termination, which in no event shall be a date earlier than ninety (90) days after the date on which such Notice of Termination is given, unless an earlier date has been expressly agreed to by the Employee in writing either in advance of, or after, receiving such Notice of Termination. In the case of termination of Employee's by the Employer employment for Cause after a Change in Control of the Employer, if Employee has not previously expressly agreed in writing to the termination, then within thirty (30) days after receipt by the Employee of the Notice of Termination with respect thereto, the Employee may notify the Employer that a dispute exists concerning the termination, in which event the Date of Termination shall be either the date set by mutual written consent of the parties or the date the dispute is resolved. During the pendency of any such dispute, the Employee will continue to be paid his full compensation in effect prior to the time the Notice of Termination is given and until the dispute is resolved. It is anticipated that an Employee's Date of Termination, as described above in this Section I.F., will constitute a "separation from service" within the meaning of Code section 409A and Treasury Regulations thereunder. In the event that an Employee's Date of Termination as described above differs from the date of the Employee's separation from service for purposes of Code section 409A, the Employee's Date of Termination for purposes of this Agreement will be the date of his separation from service under Code section 409A.

G. "Disability" means (i) as a result of Employee's inability due to physical or mental illness, Employee shall have been absent from the full-time performance of his duties with the Employer and/or Bank for six (6) consecutive months, and (ii) within thirty (30) days after Notice of Termination is given Employee shall not have returned to the full-time performance of his duties.

H. "Employer" and "Bank" includes any corporation or other entity which is the surviving or continuing entity in respect of any merger, consolidation or form of business combination in which the Employer or Bank, respectively, ceases to exist.

I. "Employment Year" means the 12-month period beginning on the Initial Date and each 12-month period beginning on the annual anniversary date thereafter.

J. "Good Reason" means:

(i) An adverse change in Employee's status or positions as an officer or director of the Employer or Bank including, without limitation, any adverse change in Employee's status or position as a result of a material diminution of his duties or responsibilities (other than, if applicable, any such change directly attributable to the fact that Employer is no longer publicly owned, except that Employer, Bank or Successor may not use the fact that Employer is no longer publicly owned to justify taking any action mentioned in this Section I(J) which is detrimental to the Employee or adverse to his best interests) or the assignment to Employee of any duties or responsibilities which, in Employee's reasonable judgment, are inconsistent with such status or positions, or any removal of Employee from or any failure to reappoint or reelect Employee to such positions (except in connection with the termination of Employee's employment for Cause, Disability or Retirement or as a result of Employee's death or by Employee other than for Good Reason);

(ii) The failure by the Employer to obtain from any Successor the assent to this Agreement hereinafter required;

(iii) Any purported termination by the Employer, Bank or Successor of the Employee's employment which is not effected pursuant to a Notice of Termination satisfying the requirements of Section I(M) hereof (and, if applicable, Section I(C) hereof); and for purposes of this Agreement, no such purported termination shall be effective;

(iv) Unless specifically agreed to in writing by Employee, the failure by Employer, Bank or

Successor to continue in effect any Plans in which Employee participates on November 1, 2008, (or Plans providing Employee with at least substantially similar benefits) other than as a result of the normal expiration of any such Plan in accordance with its terms as in effect at the time of the Change in Control, or the taking of any action, or the failure to act, by Employer, Bank or Successor which would adversely affect Employee's continued participation in any of such Plans on at least as favorable a basis as existing on November 1, 2008, or which would materially reduce Employee's benefits in the future under any such Plans or deprive Employee of any material benefit enjoyed by the Employee on November 1, 2008;

(v) Unless specifically agreed to in writing by Employee, the failure by Employer, Bank or Successor to provide and credit Employee with a number of paid vacation days to which Employee would then be entitled in accordance with this Agreement or in accordance with the Employer's or Bank's normal vacation policy as in effect on November 1, 2008, whichever is greater;

(vi) Unless specifically agreed to in writing by Employee, the requirement by Employer, Bank or Successor that Employee be based anywhere other than where his office is located on November 1, 2008, except for required travel on business for the Employer, Bank or Successor to an extent substantially consistent with the business travel obligations which Employee undertook on behalf of Employer and/or Bank prior to November 1, 2008;

(vii) Unless specifically agreed to in writing by Employee, any refusal by Employer, Bank or Successor to continue to allow Employee to attend to matters or engage in activities not directly related to the business of the Employer, Bank or Successor which, prior to November 1, 2008, Employee was permitted by Employer or Bank to attend to or engage in; or

(viii) In the event of a Change in Control of the Employer, termination of employment hereunder by the Employee for any reason other than death or Disability pursuant to a Notice of Termination given during the thirty (30) day period immediately following the first annual anniversary of such Change in Control.

K. "Incumbent Board" means the Board as constituted on the date hereof.

L. "Initial Date" means September 21, 2000.

M. "Notice of Termination" means a written notice that indicates the specific termination provision of this Agreement relied upon and sets forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of Employee's employment under the provision so indicated.

N. "Person" has the meaning ascribed to that term in Sections 3(a)(9) and 13(d)(3) of the Exchange Act.

O. "Plan" means any compensation plan such as an incentive, bonus, stock option or restricted stock plan, any pension or profit sharing plan or any welfare benefit plan (including, but not limited to health, life or disability insurance).

P. "Retirement" means Employee's voluntary termination of all employment hereunder after the attainment of age sixty-five (65) or the attainment of age fifty-five (55) having worked full time for the Employer for a period of ten (10) consecutive Employment Years.

Q. "Successor" means any Person that succeeds to, or has the practical ability to control (either immediately or with the passage of time) the Employer's business directly, by merger or consolidation, or indirectly by purchase of the Employer's voting securities, all or substantially all of its assets or otherwise.

SECTION II. TERM OF EMPLOYMENT AND DUTIES.

A. **Employment with Employer and Bank.** Employer hereby employs Employee hereunder as of the Initial Date as President and Chief Executive Officer of Employer and Bank. Employee shall be expected to perform such services as are generally performed by the president and chief executive officer of a bank holding company and commercial bank. The services to be performed may be extended or curtailed from time to time at the direction of the Board or the Bank Board during the term of this Agreement; provided, however, such duties shall not be extended or curtailed in such fashion as to alter the duties and responsibilities generally expected of the president and chief executive officer of a bank holding company or a commercial bank, as the case may be. If Employee serves on the Board, he shall serve as a member of such committees as the Board may designate, subject to the terms hereof. If Employee serves on the Bank Board, he shall serve as a member of such committees as the Bank Board may designate, subject to the terms hereof.

B. **Acceptance of Employment.** Employee accepts such employment hereunder and shall devote his full time, attention and best efforts to the diligent performance of his duties herein specified and as an officer of Employer and Bank. While employed hereunder, Employee will not, without the prior express written consent of the Board, accept employment with any other individual, corporation, partnership, governmental authority or other entity, or engage in any other venture for profit which the Board may consider to be in conflict with Employer's or Bank's best interest or to be in competition with Employer's or Bank's business, or which may interfere in any way with Employee's performance of his duties hereunder. It is understood and agreed that Employee has the right to participate in passive investments.

C. **Term of Employment.** This Agreement shall continue in effect until the third anniversary of the Initial Date; provided, however, that beginning with the first anniversary of the Initial Date and each anniversary thereafter, the term of this Agreement shall automatically be extended for one additional year unless at least one hundred twenty (120) days prior to such anniversary date, the Employer or the Employee shall have given written notice that this Agreement shall not be extended, and provided further, anything in this Agreement to the contrary notwithstanding, this Agreement shall continue in effect for at least a period of thirty-six (36) months beyond the date of a Change in Control, if one shall have occurred (i) during the term of this Agreement, and (ii) prior to a Notice of Termination, except a Notice of Termination given by Employer other than for Cause or Disability after any regulatory filing has been made in contemplation of a Change in Control.

D. **Termination of Employment.** The Employee's employment with the Employer shall be terminated as of the first to occur of any of the following:

- (i) the death of Employee;
- (ii) the Disability of Employee;
- (iii) the discharge of Employee for Cause;
- (iv) the termination by Employee for Good Reason; and
- (v) any other termination of Employee's employment with Employer.

E. **Offices.** Termination of employment hereunder shall include termination of employment as President and Chief Executive Officer of both the Employer and the Bank.

SECTION III. COMPENSATION AND RELATED MATTERS.

A. Base Salary. Employee's annual base salary for an Employment Year shall be \$320,000.00, payable in accordance with the Company's normal payroll schedule. The Board may increase the base salary, in its sole discretion, based on factors it deems appropriate, such as increased responsibilities and cost of living increases.

B. Employee Benefits. Subject to meeting applicable eligibility provisions, Employee shall be entitled to participate in all employee benefits Plans or arrangements of Employer and/or Bank, on the same basis as other executives of the Employer and/or Bank including, without limitation, Plans or arrangements providing medical or dental insurance (the cost of coverage for dependents to be borne by Employee), life insurance, disability insurance, accidental death or dismemberment insurance, sick leave and retirement benefits through plans which are qualified under the Code.

C. Auto Allowance. Employee shall be entitled to an automobile allowance in the amount of \$1,033.00 per month, payable in accordance with the Company's normal payroll schedule.

D. Expenses. Employee shall be entitled to receive prompt reimbursement for all reasonable and customary expenses incurred, during the term of this Agreement, by him in performing services hereunder in accordance with the general policies and procedures established in writing by the Employer and/or Bank. Unless otherwise specified in those written policies and procedures, such reimbursement shall be made within thirty (30) days following Employee's submission of related receipts or other information required by the Employer and/or Bank. The amount of expenses eligible for reimbursement during a calendar year shall not affect expenses eligible for reimbursement in any other calendar year.

E. Performance Bonus. In addition to compensation enumerated above, Employee may receive a cash bonus for each Employment Year in such amounts and at such times as the Board, in its sole discretion, determines. Employee shall receive an annual performance review, and the Board may use the results of such review in determining the amount of any bonus to be awarded.

F. Vacation. Employee shall be entitled to at least five (5) weeks of paid vacation during each Employment Year during the term of this Agreement, which he shall be entitled to take at such time or times as in the reasonable judgment of Employer shall not materially interfere with the conduct of his duties under this Agreement.

SECTION IV. TERMINATION OF EMPLOYMENT.

A. Prior to Change in Control; Voluntary Termination; Cause. Prior to a Change in Control, upon the Employee's termination of his employment for other than Good Reason, or upon the termination of Employee's employment by the Employer for Cause, or upon Employee's death, the Employer shall pay the Employee his full base salary through the Date of Termination at the rate in effect at the time Notice of Termination is given and all other unpaid amounts, if any, to which Employee is entitled as of the Date of Termination under any Plan or arrangement of Employer or Bank at the time such payments are due. No Notice of Termination is required hereunder in the event of Employee's death, and the foregoing amounts shall be determined on the date of death, if applicable.

B. Prior to Change in Control; Good Reason, etc. Prior to a Change in Control, upon the termination of the Employee's employment (i) by Employer for reasons other than Cause or Disability or (ii) by Employee for Good Reason, Employer shall pay Employee a lump sum payment equal to the total base salary that Employee would have earned had Employee continued in the Employer's employ through the remaining term of this Agreement, such base salary to be at the rate in effect at the time Notice of Termination is given. Such lump sum payment shall be made on the first day of the month following the six-month anniversary of the Employee's Date of Termination. Interest shall accrue on the payment from Employee's Date of Termination through the date of

payment at the Prime Rate of Interest in effect on the Date of Termination and as reported in the Wall Street Journal.

C. Upon Change in Control. Upon termination of Employee's employment within thirty-six (36) months following a Change in Control of the Employer, unless such termination is (i) because of Employee's death or Retirement, (ii) by Employer for Cause or Disability, (iii) by Employee other than for Good Reason or (iv) pursuant to a Notice of Termination given prior to a Change in Control except when such Notice of Termination is given by Employer after any regulatory filing has been made in contemplation of a Change in Control (in which event Section IV(A) or IV(B), as the case may be, shall govern such termination), Employer shall pay to Employee an amount equal to 2.99 multiplied by the Employee's annualized includable compensation for the base period, within the meaning of Section 280G(d)(1) of the Internal Revenue Code of 1986, as amended ("Code"), provided, however, that if any of such payment is or will be subject to the excise tax imposed by Section 4999 of the Code or any similar tax that may hereafter be imposed ("Excise Tax") such payment shall be reduced to a smaller amount, even to zero, which smaller amount shall be the largest amount payable under this paragraph that would not be subject in whole or in part to the Excise Tax after considering all other payments to Employee required to be considered under Section 4999 or 280G of the Code, and taking into account the payment date prescribed in the following sentence. Such payment shall be: (i) referred to as the "Severance Payment," (ii) determined by a certified public accounting firm selected by Executive, which shall provide detailed supporting calculations to Employer and Employee, and (iii) made on the first day of the month following the six-month anniversary of the Employee's Date of Termination. All fees and expenses of the accounting firm shall be the responsibility of and paid by the Employer.

D. Offset. The amount of any payment provided for in this Section IV shall not be reduced, offset or subject to recovery by the Employer, Bank or Successor by reason of any compensation earned by Employee as the result of employment by another employer after the Date of Termination, or otherwise.

SECTION V. SPLIT-DOLLAR ARRANGEMENT.

Employer and Employee have entered into a split-dollar insurance agreement that governs the rights and responsibilities of Employer and Employee with respect to the policy covered by such agreement.

SECTION VI. ANNUAL PHYSICAL EXAMINATION.

At least once a year during the term of this Agreement beginning with the Initial Date, the Employee shall undergo a routine physical examination, which physical examination shall include such procedures as are customarily performed in routine physical examinations of executives, such as an electrocardiogram, a chest x-ray, and urinalysis. Specific procedures or tests shall be included as a part of such routine physical examination as the Employer specifies from time to time. Employee may select his own physician to perform the examination. Employee agrees to immediately notify the Human Resources Committee of the Board if the annual examination reveals any issues that may prevent Employee from performing his duties under the terms of this Agreement. Employee shall be reimbursed for the ordinary, customary and reasonable cost of such a physical upon his submitting to the Employer invoices for the expenses incurred, the date such expense was incurred and the person or party providing the services, and the Employee shall be responsible for the remainder of the expenses. Employer shall not reimburse Employee for any portion of the cost of such routine physical examination which is actually paid for by any health insurance coverage applicable to Employee. Employer shall reimburse Employee within thirty (30) days following Employee's submission of related receipts or other information necessary for Employer to determine the amount of the reimbursement to which Employee is entitled. The amount of expenses eligible for reimbursement during a calendar year shall not affect expenses eligible for reimbursement in any other calendar year, except to the extent permitted by Treasury Regulations section 1.409A-3(iv)(B) (relating to medical reimbursement arrangements).

SECTION VII. SUCCESSORS; BINDING AGREEMENT.

A. Agreement of Employer's Successor. Employer will have any Successor, by agreement in form and substance satisfactory to Employee, assent to the fulfillment by Employer of its obligations under this Agreement. Failure of Employer to obtain such assent at least three business days prior to the time a Person becomes a Successor (or where Employer does not have at least three business days advance notice that a Person may become a Successor, within one business day after having notice that such Person may become or has become a Successor) shall constitute Good Reason for termination by Employee of his employment and, if a Change of Control of the Employer has occurred, shall entitle Employee immediately to the benefits provided in Section IV(C) hereof upon delivery by Employer of a Notice of Termination.

B. Binding Agreement. This Agreement shall inure to the benefit of and be enforceable by Employee's personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees. If Employee should die while any amount would still be payable to Employee hereunder if the Employee had continued to live, all such amounts, unless otherwise provided herein, shall be paid in accordance with the terms of this Agreement to Employee's beneficiary designated in writing and delivered to Employer, if any, and if none to Employee's estate.

SECTION VIII. FEES AND EXPENSES.

Each party shall pay its own legal fees and related or other expenses incurred in connection with this Agreement, whether or not such party prevails, including, without limitation all such fees and expenses, if any, incurred in contesting or disputing any termination or seeking to obtain or enforce any right or benefit provided by this Agreement. The foregoing notwithstanding, following a Change in Control of the Employer, the Employer shall pay all legal fees and related expenses incurred at any time following such Change of Control by Employee in connection with this Agreement, whether or not Employee prevails, including, without limitation, all such fees and expenses, if any, incurred by Employee in contesting or disputing any termination of Employee, in seeking advice with respect to the matters set forth in this Agreement, or in seeking to obtain or enforce any right or benefit provided by this Agreement. Employer shall reimburse Employee within thirty (30) days following Employee's submission to Employer of receipts or other information indicating the amount of reimbursement to which he is entitled, or Employee may elect to have Employer pay his legal counsel or other service provider directly, in which case such payment shall be made within thirty (30) days following Employee's submission to Employer of statements showing fees and expenses for services rendered. The amount of in-kind benefits or expenses eligible for reimbursement during a calendar year under this Section VIII shall not affect in-kind benefits or expenses eligible for reimbursement in any other calendar year.

SECTION IX. TAXES.

All payments to be made to Employee under this Agreement will be subject to required withholding of federal, state and local and employment and other taxes.

SECTION X. MISCELLANEOUS.

A. Survival. The respective obligations of, and benefits afforded to, Employer and Employee in Sections IV, VII(B), VIII, IX and XI of this Agreement shall survive termination of this Agreement.

B. Notice. For the purposes of this Agreement, notices and all other communications provided for in the Agreement shall be in writing and shall be deemed to have been duly given when delivered to Employee or the Chairman of the Board of Employer or mailed by United States registered mail, return receipt requested, postage prepaid and addressed, in the case of Employer, to the attention of the Chairman of the Board at the following address:

Valley Financial Corporation
36 Church Avenue SW
Roanoke, VA 24011

or, in the case of Employee, to the address set forth below the Employee's signature, provided that all notices may be sent to such other address as either party may have furnished to the other in writing in accordance herewith, except that notice of change of address shall be effective only upon receipt.

C. Modification; Waiver. No provision of this Agreement may be modified, waived or discharged unless such modification, waiver or discharge is agreed to in writing signed by Employee and the Chairman of the Board of Employer. No waiver by either party hereto at any time of any breach by the other party hereto of, or compliance with, any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of a similar or dissimilar provisions or conditions at the same or at any prior or subsequent time. No agreements or representations, oral or otherwise, express or implied, with respect to the subject matter hereof have been made by either party which are not expressly set forth in this Agreement. The validity, interpretation, construction and performance of this Agreement shall be governed by the laws of the Commonwealth of Virginia.

D. Validity. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision of this Agreement, which shall remain in full force and effect.

E. Code Section 409A. Any benefit, payment or other right provided by this Agreement shall be provided and made in a manner, and at such time, in such form and subject to such election procedures (if any), as complies with the applicable requirements of Code section 409A to avoid a plan failure described in Code section 409A(a)(1), including without limitation, deferring payment until the occurrence of a specified payment event described in Code section 409A(a)(2). Notwithstanding any other provision hereof or document pertaining hereto, this Agreement shall be so construed and interpreted.

SECTION XI. CONFIDENTIALITY; COVENANT NOT TO COMPETE.

A. Confidentiality. Employee agrees that subsequent to his period of employment with Employer and/or Bank, he will not at any time communicate or disclose to any unauthorized person, without the written consent of the Employer, any proprietary or other confidential information concerning the Employer or any subsidiary of the Employer; it being understood, however, that the obligations of this Section shall not apply to the extent that the aforesaid matters (i) are disclosed in circumstances where Employee is legally required to do so or (ii) become generally known to and available for use by the public otherwise than by the Employee's wrongful act or omission.

B. Covenant Not to Compete. If the Employee's employment with the Employer and/or Bank is terminated by Employee other than for Good Reason or by Employer other than for Cause, the Employee agrees that for a period of three (3) years from the date his employment is terminated, he will not, without the consent in writing of the Chairman of the Board of the Employer, become an officer, employee, agent, partner, director or substantial stockholder of any entity engaged in the commercial or retail banking business within a 100 mile radius of the City of Roanoke, Virginia, or become associated in any substantial manner with any entity in the process of formation to engage in the retail or commercial banking business, or any group that intends to form any such entity in the geographical area described above.

C. Relief. In the event of Employee's actual or threatened breach of this Section, the Employer or Bank shall be entitled to a preliminary restraining order and an injunction restraining the Employee from violating its provisions. In the event the Employee terminates his employment for other than Good Reason and his actual date of terminating his employment is less than ninety (90) days after his Notice of Termination, the Employee will pay to the Employer, as liquidated damages and not as a penalty, an amount equal to the

Employee's base salary then in effect, computed on a per diem basis, multiplied by ninety (90).

D. Other Remedies. Nothing in this Agreement shall be construed to prohibit the Employer or Bank from pursuing any other available remedies for such breach or threatened breach, including the recovery of damages from the Employee. If at the time of enforcement of this Section a court holds that the duration, scope or area restrictions stated herein are unreasonable under the circumstances then existing and, thus, unenforceable, the Employer and Employee agree that the maximum duration, scope or area reasonable under such circumstances shall be substituted for the stated duration, scope or area.

SECTION XII. RELATED AGREEMENTS.

To the extent that any provision of any other agreement between Employer or any of its subsidiaries and Employee shall limit, qualify or be inconsistent with any provision of this Agreement, then for purposes of this Agreement, while the same shall remain in force, the provision of this Agreement shall control and such provision of such other agreement shall be deemed to have been superseded, and to be of no force or effect, as if such other agreement had been formally amended to the extent necessary to accomplish such purpose.

SECTION XIII. COUNTERPARTS.

This Agreement may be executed in several counterparts, each of which shall be deemed to be an original but all of which together will constitute one and the same instrument.

IN WITNESS WHEREOF, the parties have executed this amended and restated Agreement as of the dates set forth below, to be effective November 1, 2008.

VALLEY FINANCIAL CORPORATION

By: /s/ William Elliot
Title: Chair, Human Resources Committee

Date: November 12, 2008

EMPLOYEE

/s/ Ellis L. Gutshall
Ellis L. Gutshall

Date: November 12, 2008

Address: 449 Canterbury Lane, SW
Roanoke, VA 24014

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Section 3: EX-10.2 (EMPLOYMENT AGREEMENT)

Exhibit 10.2

EMPLOYMENT AGREEMENT BETWEEN VALLEY FINANCIAL CORPORATION AND KIMBERLY B. SNYDER

This Employment Agreement ("Agreement"), dated for purposes of identification and effective November 1, 2008 (the "Effective Date"), is made and entered into between Valley Financial Corporation ("Employer"), a bank holding company owning all of the outstanding capital stock of Valley Bank ("Bank") and Kimberly B. Snyder ("Employee"). This Agreement, as amended and restated, is intended to comply with the requirements of Section 409A of the Internal Revenue Code of 1986, as amended.

WHEREAS, Employer desires to employ Employee as Executive Vice President and Chief Financial Officer of the Employer and the Bank; and

WHEREAS, Employee is willing to accept such positions with the Employer and Bank.

NOW, THEREFORE, in consideration of the premises and mutual covenants and agreements hereinafter set forth, the parties hereto agree as follows:

SECTION I. DEFINITIONS.

As used in this Agreement, the following capitalized terms have the indicated meanings unless the context clearly requires otherwise:

- A. "Bank Board" means the Board of Directors of the Bank.
- B. "Board" means the Board of Directors of the Employer.

C. "Cause" means (i) the willful and continued failure by Employee to substantially perform her duties hereunder (other than any such failure resulting from her incapacity due to physical or mental illness) after a written demand for substantial performance is delivered to the Employee by the Board (excluding Employee) and which failure has not been cured as hereinafter provided, which demand specifically identifies the manner in which the Board believes that Employee has not substantially performed her duties, or (ii) the willful engaging by the Employee in illegal conduct or any conduct which is demonstrably and materially injurious to the Employer or Bank. Without limiting the generality of the foregoing, Cause shall include the issuance of a removal order or similar order by a governmental regulatory agency with appropriate jurisdiction prohibiting Employee from participating in the affairs of the Employer or Bank. Any act or failure to act based upon authority given pursuant to a resolution duly adopted by the Board or Bank Board or based upon the advice of counsel for the Employer or Bank shall be conclusively presumed to be done, or omitted to be done, by the Employee in good faith and in the best interests of the Employer and Bank. It is also expressly understood that the Employee's attention to matters not directly related to the business of the Employer or Bank shall not provide a basis for termination for Cause so long as the Employer and/or Bank has approved Employee's engagement in such activities. Upon the issuance of a written demand for substantial performance, Employee shall have a reasonable period of time in which to correct such alleged violation, provided, however, that the alleged violation is neither dishonest nor criminal. It is agreed that thirty (30) days shall be deemed a reasonable time in which to correct any such alleged violation. If the Employee is unable to correct the alleged violation within said thirty (30) day period, then if the Board (excluding Employee) determines that the Employee is using her best efforts to make such correction and that the alleged violation can be corrected, the Board shall extend the thirty (30) day period by such time as is reasonably necessary for the Employee to effect such correction as expeditiously as practicable. Notwithstanding the

foregoing, after a Change in Control of the Employer the Employee shall not be deemed to be terminated for Cause unless and until there shall have been delivered to Employee a copy of a resolution duly adopted by the affirmative vote of not less than 75% of the entire membership of the Board (excluding Employee) at a meeting of such Board called and held for such purpose (after a reasonable notice to Employee and an opportunity for Employee, together with her counsel, to be heard before the Board), finding that in the good faith opinion of the Board the Employee was guilty of conduct set forth above and specifying the particulars thereof in detail. In such event Employee shall have a reasonable period of time in which to correct the alleged violation, provided, however, that the alleged violation is neither dishonest nor criminal. As in the case of an alleged violation prior to a Change in Control, it is agreed that thirty (30) days (extended by the Board, if necessary, as outlined above) shall be deemed a reasonable time in which to correct any such alleged violation.

D. "Change in Control" or "Change in Control of the Employer" means a change in control of a nature that would be required to be reported (assuming such event has not been "previously reported") in response to Item I(a) of the Current Report on Form 8-K, as in effect on the date hereof, pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended ("Exchange Act"); provided that, notwithstanding the foregoing and without limitation, such a change in control shall be deemed to have occurred at such time as (i) any Person is or becomes the "beneficial owner" (as defined in Rule 13d-3 or Rule 13d-5 under the Exchange Act as in effect on January 1, 1994), directly or indirectly, of 20% or more of the combined voting power of the Employer's voting securities; (ii) the Incumbent Board ceases for any reason to constitute at least the majority of the Board, provided that any person becoming a director subsequent to the date hereof whose election, or nomination for election by the Employer's shareholders, was approved by a vote of at least 75% of the directors comprising the Incumbent Board (either by a specific vote or by approval of the proxy statement of the Employer in which such person is named as a nominee for director, without objection to such nomination) shall be, for purposes of this clause (ii) considered as though such person were a member of the Incumbent Board; (iii) all or substantially all of the assets of the Employer or the assets of the Bank are sold, transferred or conveyed by any means, including but not limited to direct purchase or merger, if the transferee is not controlled by the Employer, control meaning the ownership of more than 50% of the combined voting power of such entity's voting securities; or (iv) the Employer is merged or consolidated with another corporation or entity and as a result of such merger or consolidation less than 75% of the outstanding voting securities of the surviving or resulting corporation or entity shall be owned in the aggregate by the former shareholders of the Employer. Notwithstanding anything in the foregoing to the contrary, no change in control shall be deemed to have occurred for purposes of this Agreement by virtue of any transaction (i) which results in the Employee or a group of Persons which includes the Employee, acquiring, directly or indirectly, 20% or more of the combined voting power of the Employer's voting securities; (ii) arranged or caused by a federal bank regulatory agency possessing appropriate jurisdiction on the grounds of failing financial condition of the Employer or Bank which results in the acquisition, directly or indirectly, of 20% or more of the combined voting power of the Employer's voting securities by any Person or (iii) which results in the Employer, any subsidiary of the Employer or any profit-sharing plan, employee stock ownership plan or employee benefit plan of the Employer or any of its subsidiaries (or any trustee of or fiduciary with respect to any such plan acting in such capacity) acquiring, directly or indirectly, 20% or more of the combined voting power of the Employer's voting securities.

E. "Code" means the Internal Revenue Code of 1986, as amended from time to time.

F. "Date of Termination" means (i) if Employee's employment is terminated by Employee for other than Good Reason, ninety (90) days after Notice of Termination is given, (ii) if Employee's employment is to be terminated for Disability, thirty (30) days after Notice of Termination is given (provided that the Employee shall not have returned to the performance of her duties on a full-time basis during such thirty (30) day period), (iii) except as otherwise provided in this paragraph, if Employee's employment is to be terminated by the Employer for Cause or by the Employee for Good Reason, the date specified in the Notice of Termination, (iv) the date of Employee's death, or (v) if Employee's employment is to be terminated by the Employer for any reason other than

Cause or Disability, the date specified in the Notice of Termination, which in no event shall be a date earlier than ninety (90) days after the date on which such Notice of Termination is given, unless an earlier date has been expressly agreed to by the Employee in writing either in advance of, or after, receiving such Notice of Termination. In the case of termination of Employee's by the Employer employment for Cause after a Change in Control of the Employer, if Employee has not previously expressly agreed in writing to the termination, then within thirty (30) days after receipt by the Employee of the Notice of Termination with respect thereto, the Employee may notify the Employer that a dispute exists concerning the termination, in which event the Date of Termination shall be either the date set by mutual written consent of the parties or the date the dispute is resolved. During the pendency of any such dispute, the Employee will continue to be paid her full compensation in effect prior to the time the Notice of Termination is given and until the dispute is resolved. It is anticipated that an Employee's Date of Termination, as described above in this Section I.F., will constitute a "separation from service" within the meaning of Code section 409A and Treasury Regulations thereunder. In the event that an Employee's Date of Termination as described above differs from the date of the Employee's separation from service for purposes of Code section 409A, the Employee's Date of Termination for purposes of this Agreement will be the date of her separation from service under Code section 409A.

G. "Disability" means (i) as a result of Employee's inability due to physical or mental illness, Employee shall have been absent from the full-time performance of her duties with the Employer and/or Bank for six (6) consecutive months, and (ii) within thirty (30) days after Notice of Termination is given Employee shall not have returned to the full-time performance of her duties.

H. "Employer" and "Bank" includes any corporation or other entity which is the surviving or continuing entity in respect of any merger, consolidation or form of business combination in which the Employer or Bank, respectively, ceases to exist.

I. "Employment Year" means the 12-month period beginning on the Effective Date and each 12-month period beginning on the annual anniversary date thereafter.

J. "Good Reason" means:

(i) An adverse change in Employee's status or positions as an officer or director of the Employer or Bank including, without limitation, any adverse change in Employee's status or position as a result of a material diminution of her duties or responsibilities (other than, if applicable, any such change directly attributable to the fact that Employer is no longer publicly owned, except that Employer, Bank or Successor may not use the fact that Employer is no longer publicly owned to justify taking any action mentioned in this Section I(J) which is detrimental to the Employee or adverse to her best interests) or the assignment to Employee of any duties or responsibilities which, in Employee's reasonable judgment, are inconsistent with such status or positions, or any removal of Employee from or any failure to reappoint or reelect Employee to such positions (except in connection with the termination of Employee's employment for Cause, Disability or Retirement or as a result of Employee's death or by Employee other than for Good Reason);

(ii) The failure by the Employer to obtain from any Successor the assent to this Agreement hereinafter required;

(iii) Any purported termination by the Employer, Bank or Successor of the Employee's employment which is not effected pursuant to a Notice of Termination satisfying the requirements of Section I(M) hereof (and, if applicable, Section I(C) hereof); and for purposes of this Agreement, no such purported termination shall be effective;

(iv) Unless specifically agreed to in writing by Employee, the failure by Employer, Bank or

Successor to continue in effect any Plans in which Employee participates on November 1, 2008, (or Plans providing Employee with at least substantially similar benefits) other than as a result of the normal expiration of any such Plan in accordance with its terms as in effect at the time of the Change in Control, or the taking of any action, or the failure to act, by Employer, Bank or Successor which would adversely affect Employee's continued participation in any of such Plans on at least as favorable a basis as existing on November 1, 2008, or which would materially reduce Employee's benefits in the future under any such Plans or deprive Employee of any material benefit enjoyed by the Employee on November 1, 2008;

(v) Unless specifically agreed to in writing by Employee, the failure by Employer, Bank or Successor to provide and credit Employee with a number of paid vacation days to which Employee would then be entitled in accordance with this Agreement or in accordance with the Employer's or Bank's normal vacation policy as in effect on November 1, 2008, whichever is greater;

(vi) Unless specifically agreed to in writing by Employee, the requirement by Employer, Bank or Successor that Employee be based anywhere other than where her office is located on November 1, 2008, except for required travel on business for the Employer, Bank or Successor to an extent substantially consistent with the business travel obligations which Employee undertook on behalf of Employer and/or Bank prior to November 1, 2008;

(vii) Unless specifically agreed to in writing by Employee, any refusal by Employer, Bank or Successor to continue to allow Employee to attend to matters or engage in activities not directly related to the business of the Employer, Bank or Successor which, prior to November 1, 2008, Employee was permitted by Employer or Bank to attend to or engage in; or

(viii) In the event of a Change in Control of the Employer, termination of employment hereunder by the Employee for any reason other than death or Disability pursuant to a Notice of Termination given during the thirty (30) day period immediately following the first annual anniversary of such Change in Control.

K. "Incumbent Board" means the Board as constituted on the date hereof.

L. "Notice of Termination" means a written notice that indicates the specific termination provision of this Agreement relied upon and sets forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of Employee's employment under the provision so indicated.

M. "Person" has the meaning ascribed to that term in Sections 3(a)(9) and 13(d)(3) of the Exchange Act.

N. "Plan" means any compensation plan such as an incentive, bonus, stock option or restricted stock plan, any pension or profit sharing plan or any welfare benefit plan (including, but not limited to health, life or disability insurance).

O. "Retirement" means Employee's voluntary termination of all employment hereunder after the attainment of age sixty-five (65) or the attainment of age fifty-five (55) having worked full time for the Employer for a period of ten (10) consecutive Employment Years.

P. "Successor" means any Person that succeeds to, or has the practical ability to control (either immediately or with the passage of time) the Employer's business directly, by merger or consolidation, or indirectly by purchase of the Employer's voting securities, all or substantially all of its assets or otherwise.

SECTION II. TERM OF EMPLOYMENT AND DUTIES.

A. Employment with Employer and Bank. Employer hereby employs Employee hereunder as of the Effective Date as Executive Vice President and Chief Financial Officer of Employer and Bank. Employee shall be expected to perform such services as are generally performed by the executive vice president and chief financial officer of a bank holding company and commercial bank. The services to be performed may be extended or curtailed from time to time at the direction of the Board or the Bank Board during the term of this Agreement; provided, however, such duties shall not be extended or curtailed in such fashion as to alter the duties and responsibilities generally expected of the executive vice president and chief financial officer of a bank holding company or a commercial bank, as the case may be.

B. Acceptance of Employment. Employee accepts such employment hereunder and shall devote her full time, attention and best efforts to the diligent performance of her duties herein specified and as an officer of Employer and Bank. While employed hereunder, Employee will not, without the prior express written consent of the Board, accept employment with any other individual, corporation, partnership, governmental authority or other entity, or engage in any other venture for profit which the Board may consider to be in conflict with Employer's or Bank's best interest or to be in competition with Employer's or Bank's business, or which may interfere in any way with Employee's performance of her duties hereunder. It is understood and agreed that Employee has the right to participate in passive investments.

C. Term of Employment. This Agreement shall continue in effect until the second anniversary of the Effective Date; provided, however, that beginning with the first anniversary of the Effective Date and each anniversary thereafter, the term of this Agreement shall automatically be extended for one additional year unless at least one hundred twenty (120) days prior to such anniversary date, the Employer or the Employee shall have given written notice that this Agreement shall not be extended, and provided further, anything in this Agreement to the contrary notwithstanding, this Agreement shall continue in effect for at least a period of twenty-four (24) months beyond the date of a Change in Control, if one shall have occurred (i) during the term of this Agreement, and (ii) prior to a Notice of Termination, except a Notice of Termination given by Employer other than for Cause or Disability after any regulatory filing has been made in contemplation of a Change in Control.

D. Termination of Employment. The Employee's employment with the Employer shall be terminated as of the first to occur of any of the following:

- (i) the death of Employee;
- (ii) the Disability of Employee;
- (iii) the discharge of Employee for Cause;
- (iv) the termination by Employer for Good Reason; and
- (v) any other termination of Employee's employment with Employer.

E. Offices. Termination of employment hereunder shall include termination of employment as Executive Vice President and Chief Financial Officer of both the Employer and the Bank.

SECTION III. COMPENSATION AND RELATED MATTERS.

A. Base Salary. Employee's annual base salary for an Employment Year shall be \$175,000.00, payable in accordance with the Company's normal payroll schedule. The Board may increase the base salary, in its sole discretion, based on factors it deems appropriate, such as increased responsibilities and cost of living increases.

B. Employee Benefits. Subject to meeting applicable eligibility provisions, Employee shall be

entitled to participate in all employee benefits Plans or arrangements of Employer and/or Bank, on the same basis as other executives of the Employer and/or Bank including, without limitation, Plans or arrangements providing medical or dental insurance (the cost of coverage for dependents to be borne by Employee), life insurance, disability insurance, accidental death or dismemberment insurance, sick leave and retirement benefits through plans which are qualified under the Code.

C. Expenses. Employee shall be entitled to receive prompt reimbursement for all reasonable and customary expenses incurred, during the term of this Agreement, by him in performing services hereunder in accordance with the general policies and procedures established in writing by the Employer and/or Bank. Unless otherwise specified in those written policies and procedures, such reimbursement shall be made within thirty (30) days following Employee's submission of related receipts or other information required by the Employer and/or Bank. The amount of expenses eligible for reimbursement during a calendar year shall not affect expenses eligible for reimbursement in any other calendar year.

D. Performance Bonus. In addition to compensation enumerated above, Employee may receive a cash bonus for each Employment Year in such amounts and at such times as the Board, in its sole discretion, determines. Employee shall receive an annual performance review, and the Board may use the results of such review in determining the amount of any bonus to be awarded.

E. Vacation. Employee shall be entitled to at least five (5) weeks of paid vacation during each Employment Year during the term of this Agreement, which she shall be entitled to take at such time or times as in the reasonable judgment of Employer shall not materially interfere with the conduct of her duties under this Agreement.

SECTION IV. TERMINATION OF EMPLOYMENT.

A. Prior to Change in Control; Voluntary Termination; Cause. Prior to a Change in Control, upon the Employee's termination of her employment for other than Good Reason, or upon the termination of Employee's employment by the Employer for Cause, or upon Employee's death, the Employer shall pay the Employee her full base salary through the Date of Termination at the rate in effect at the time Notice of Termination is given and all other unpaid amounts, if any, to which Employee is entitled as of the Date of Termination under any Plan or arrangement of Employer or Bank at the time such payments are due. No Notice of Termination is required hereunder in the event of Employee's death, and the foregoing amounts shall be determined on the date of death, if applicable.

B. Prior to Change in Control; Good Reason, etc. Prior to a Change in Control, upon the termination of the Employee's employment (i) by Employer for reasons other than Cause or Disability or (ii) by Employee for Good Reason, Employer shall pay Employee a lump sum payment equal to the total base salary that Employee would have earned had Employee continued in the Employer's employ through the remaining term of this Agreement, such base salary to be at the rate in effect at the time Notice of Termination is given. Such lump sum payment shall be made on the first day of the month following the six-month anniversary of the Employee's Date of Termination. Interest shall accrue on the payment from Employee's Date of Termination through the date of payment at the Prime Rate of Interest in effect on the Date of Termination and as reported in the Wall Street Journal.

C. Upon Change in Control. Upon termination of Employee's employment within thirty-six (36) months following a Change in Control of the Employer, unless such termination is (i) because of Employee's death or Retirement, (ii) by Employer for Cause or Disability, (iii) by Employee other than for Good Reason or (iv) pursuant to a Notice of Termination given prior to a Change in Control except when such Notice of Termination is given by Employer after any regulatory filing has been made in contemplation of a Change in Control (in which event Section IV(A) or IV(B), as the case may be, shall govern such termination), Employer

shall pay to Employee an amount equal to 2.99 multiplied by the Employee's annualized includable compensation for the base period, within the meaning of Section 280G(d)(1) of the Internal Revenue Code of 1986, as amended ("Code"), provided, however, that if any of such payment is or will be subject to the excise tax imposed by Section 4999 of the Code or any similar tax that may hereafter be imposed ("Excise Tax") such payment shall be reduced to a smaller amount, even to zero, which smaller amount shall be the largest amount payable under this paragraph that would not be subject in whole or in part to the Excise Tax after considering all other payments to Employee required to be considered under Section 4999 or 280G of the Code, and taking into account the payment date prescribed in the following sentence. Such payment shall be: (i) referred to as the "Severance Payment," (ii) determined by a certified public accounting firm selected by Executive, which shall provide detailed supporting calculations to Employer and Employee, and (iii) made on the first day of the month following the six-month anniversary of the Employee's Date of Termination. All fees and expenses of the accounting firm shall be the responsibility of and paid by the Employer.

D. Offset. The amount of any payment provided for in this Section IV shall not be reduced, offset or subject to recovery by the Employer, Bank or Successor by reason of any compensation earned by Employee as the result of employment by another employer after the Date of Termination, or otherwise.

SECTION V. SPLIT-DOLLAR ARRANGEMENT.

Employer and Employee have entered into a split-dollar insurance agreement that governs the rights and responsibilities of Employer and Employee with respect to the policy covered by such agreement.

SECTION VI. ANNUAL PHYSICAL EXAMINATION.

At least once a year during the term of this Agreement beginning with the Effective Date, the Employee shall undergo a routine physical examination, which physical examination shall include such procedures as are customarily performed in routine physical examinations of executives, such as an electrocardiogram, a chest x-ray, and urinalysis. Specific procedures or tests shall be included as a part of such routine physical examination as the Employer specifies from time to time. Employee may select her own physician to perform the examination. Employee agrees to immediately notify the Human Resources Committee of the Board if the annual examination reveals any issues that may prevent Employee from performing her duties under the terms of this Agreement. Employee shall be reimbursed for the ordinary, customary and reasonable cost of such a physical upon her submitting to the Employer invoices for the expenses incurred, the date such expense was incurred and the person or party providing the services, and the Employee shall be responsible for the remainder of the expenses. Employer shall not reimburse Employee for any portion of the cost of such routine physical examination which is actually paid for by any health insurance coverage applicable to Employee. Employer shall reimburse Employee within thirty (30) days following Employee's submission of related receipts or other information necessary for Employer to determine the amount of the reimbursement to which Employee is entitled. The amount of expenses eligible for reimbursement during a calendar year shall not affect expenses eligible for reimbursement in any other calendar year, except to the extent permitted by Treasury Regulations section 1.409A-3(iv)(B) (relating to medical reimbursement arrangements).

SECTION VII. SUCCESSORS; BINDING AGREEMENT.

A. Agreement of Employer's Successor. Employer will have any Successor, by agreement in form and substance satisfactory to Employee, assent to the fulfillment by Employer of its obligations under this Agreement. Failure of Employer to obtain such assent at least three business days prior to the time a Person becomes a Successor (or where Employer does not have at least three business days advance notice that a Person may become a Successor, within one business day after having notice that such Person may become or has become a Successor) shall constitute Good Reason for termination by Employee of her employment and, if a Change of Control of the Employer has occurred, shall entitle Employee immediately to the benefits provided in

Section IV(C) hereof upon delivery by Employee of a Notice of Termination.

B. Binding Agreement. This Agreement shall inure to the benefit of and be enforceable by Employee's personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees. If Employee should die while any amount would still be payable to Employee hereunder if the Employee had continued to live, all such amounts, unless otherwise provided herein, shall be paid in accordance with the terms of this Agreement to Employee's beneficiary designated in writing and delivered to Employer, if any, and if none to Employee's estate.

SECTION VIII. FEES AND EXPENSES.

Each party shall pay its own legal fees and related or other expenses incurred in connection with this Agreement, whether or not such party prevails, including, without limitation all such fees and expenses, if any, incurred in contesting or disputing any termination or seeking to obtain or enforce any right or benefit provided by this Agreement. The foregoing notwithstanding, following a Change in Control of the Employer, the Employer shall pay all legal fees and related expenses incurred at any time following such Change of Control by Employee in connection with this Agreement, whether or not Employee prevails, including, without limitation, all such fees and expenses, if any, incurred by Employee in contesting or disputing any termination of Employee, in seeking advice with respect to the matters set forth in this Agreement, or in seeking to obtain or enforce any right or benefit provided by this Agreement. Employer shall reimburse Employee within thirty (30) days following Employee's submission to Employer of receipts or other information indicating the amount of reimbursement to which she is entitled, or Employee may elect to have Employer pay her legal counsel or other service provider directly, in which case such payment shall be made within thirty (30) days following Employee's submission to Employer of statements showing fees and expenses for services rendered. The amount of in-kind benefits or expenses eligible for reimbursement during a calendar year under this Section VIII shall not affect in-kind benefits or expenses eligible for reimbursement in any other calendar year.

SECTION IX. TAXES.

All payments to be made to Employee under this Agreement will be subject to required withholding of federal, state and local and employment and other taxes.

SECTION X. MISCELLANEOUS.

A. Survival. The respective obligations of, and benefits afforded to, Employer and Employee in Sections IV, VII(B), VIII, IX and XI of this Agreement shall survive termination of this Agreement.

B. Notice. For the purposes of this Agreement, notices and all other communications provided for in the Agreement shall be in writing and shall be deemed to have been duly given when delivered to Employee or the Chairman of the Board of Employer or mailed by United States registered mail, return receipt requested, postage prepaid and addressed, in the case of Employer, to the attention of the Chairman of the Board at the following address:

Valley Financial Corporation
36 W. Church Avenue
Roanoke, VA 24011

or, in the case of Employee, to the address set forth below the Employee's signature, provided that all notices may be sent to such other address as either party may have furnished to the other in writing in accordance herewith, except that notice of change of address shall be effective only upon receipt.

C. Modification; Waiver. No provision of this Agreement may be modified, waived or discharged unless such modification, waiver or discharge is agreed to in writing signed by Employee and the Chairman of

the Board of Employer. No waiver by either party hereto at any time of any breach by the other party hereto of, or compliance with, any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of a similar or dissimilar provisions or conditions at the same or at any prior or subsequent time. No agreements or representations, oral or otherwise, express or implied, with respect to the subject matter hereof have been made by either party which are not expressly set forth in this Agreement. The validity, interpretation, construction and performance of this Agreement shall be governed by the laws of the Commonwealth of Virginia.

D. Validity. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision of this Agreement, which shall remain in full force and effect.

E. Code Section 409A. Any benefit, payment or other right provided by this Agreement shall be provided and made in a manner, and at such time, in such form and subjection to such election procedures (if any), as complies with the applicable requirements of Code section 409A to avoid a plan failure described in Code section 409A(a)(1), including without limitation, deferring payment until the occurrence of a specified payment event described in Code section 409A(a)(2). Notwithstanding any other provision hereof or document pertaining hereto, this Agreement shall be so construed and interpreted.

SECTION XI. CONFIDENTIALITY; COVENANT NOT TO COMPETE.

A. Confidentiality. Employee agrees that subsequent to her period of employment with Employer and/or Bank, she will not at any time communicate or disclose to any unauthorized person, without the written consent of the Employer, any proprietary or other confidential information concerning the Employer or any subsidiary of the Employer; it being understood, however, that the obligations of this Section shall not apply to the extent that the aforesaid matters (i) are disclosed in circumstances where Employee is legally required to do so or (ii) become generally known to and available for use by the public otherwise than by the Employee's wrongful act or omission.

B. Covenant Not to Compete. If the Employee's employment with the Employer and/or Bank is terminated by Employee other than for Good Reason or by Employer other than for Cause, the Employee agrees that for a period of two (2) years from the date her employment is terminated, she will not, without the consent in writing of the Chief Executive Officer of the Employer, become an officer, employee, agent, partner, director or substantial stockholder of any entity engaged in the commercial or retail banking business within a 100 mile radius of the City of Roanoke, Virginia, or become associated in any substantial manner with any entity in the process of formation to engage in the retail or commercial banking business, or any group that intends to form any such entity in the geographical area described above.

C. Relief. In the event of Employee's actual or threatened breach of this Section, the Employer or Bank shall be entitled to a preliminary restraining order and an injunction restraining the Employee from violating its provisions. In the event the Employee terminates her employment for other than Good Reason and her actual date of terminating her employment is less than ninety (90) days after her Notice of Termination, the Employee will pay to the Employer, as liquidated damages and not as a penalty, an amount equal to the Employee's base salary then in effect, computed on a per diem basis, multiplied by ninety (90).

D. Other Remedies. Nothing in this Agreement shall be construed to prohibit the Employer or Bank from pursuing any other available remedies for such breach or threatened breach, including the recovery of damages from the Employee. If at the time of enforcement of this Section a court holds that the duration, scope or area restrictions stated herein are unreasonable under the circumstances then existing and, thus, unenforceable, the Employer and Employee agree that the maximum duration, scope or area reasonable under such circumstances shall be substituted for the stated duration, scope or area.

SECTION XII. RELATED AGREEMENTS.

To the extent that any provision of any other agreement between Employer or any of its subsidiaries and Employee shall limit, qualify or be inconsistent with any provision of this Agreement, then for purposes of this Agreement, while the same shall remain in force, the provision of this Agreement shall control and such provision of such other agreement shall be deemed to have been superseded, and to be of no force or effect, as if such other agreement had been formally amended to the extent necessary to accomplish such purpose.

SECTION XIII. COUNTERPARTS.

This Agreement may be executed in several counterparts, each of which shall be deemed to be an original but all of which together will constitute one and the same instrument.

IN WITNESS WHEREOF, the parties have executed this amended and restated Agreement as of the dates set forth below, to be effective November 1, 2008.

VALLEY FINANCIAL CORPORATION

By: /s/ Ellis L. Gutshall
Ellis L. Gutshall, President and CEO

Date: November 12, 2008

EMPLOYEE

/s/ Kimberly B. Snyder
Kimberly B. Snyder

Date: November 12, 2008

Address: 5809 Salisbury Drive, SW
Roanoke, VA 24018

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Section 4: EX-10.3 (SPLIT-DOLLAR INSURANCE AGREEMENT)

Exhibit 10.3

Split-Dollar Insurance Agreement

This Agreement is entered into this 12th day of November 2008, by and between Valley Bank, a Virginia banking corporation (“Valley Bank”) and Kimberly B. Snyder (“Employee”);

WHEREAS, Employee is employed as Executive Vice President and Chief Financial Officer of Valley Bank; and

WHEREAS, Valley Bank desires to provide Employee with an additional incentive and inducement to continue as Valley Bank’s Executive Vice President and Chief Financial Officer.

NOW, THEREFORE, in consideration of the foregoing premises and the mutual promises of the parties set forth herein the parties hereto agree as follows:

1. Massachusetts Mutual (“Insurer”) has issued a life insurance policy (Policy Number 0079371) (“Policy”) on the life of Employee. Valley Bank is the sole owner of the Policy and has paid the entire premium of the Policy. Valley Bank is also the direct beneficiary of an amount equal to the death proceeds of the Policy less the Employee Proceeds (as hereinafter defined) (the “Valley Bank Proceeds”). All indebtedness on and any collateral assignment(s) of the Policy will be paid first from Valley Bank Proceeds. Valley Bank promises that it shall not incur indebtedness on or make any collateral assignments of the Policy which, in the aggregate, exceed the Valley Bank proceeds.

2. Employee shall have the right to designate and, from time to time, change direct and contingent beneficiaries of the Employee Proceeds and to elect and, from time to time, change a payment plan with respect to the Employee Proceeds. Employee shall have no right to designate or change beneficiaries or payment plans with respect to the Valley Bank Proceeds or to borrow against or assign the death proceeds to the extent of the Valley Bank Proceeds.

3. Valley Bank shall not sell, surrender, change the insured or transfer ownership of the Policy while this Agreement is in effect. This provision, as well as the other provisions of the Agreement restricting the rights of Valley Bank as owner of the Policy, shall have no further force and effect if this Agreement is terminated in accordance with its provisions and shall not restrict the right of Valley Bank to terminate this Agreement as provided herein. Except as expressly limited by this Agreement, Valley Bank shall have all of the rights of the owner of the Policy.

4. Policy dividends shall be applied to purchase paid up additional life insurance protection on the life of the Employee or term insurance on the life of the Employee, as shown in the illustration marked Exhibit A.

5. This Agreement shall terminate automatically upon termination of Employee’s employment with either Valley Bank or Valley Financial Corporation regardless of reason, cause or event except:

(a) Employee's death;

-
- (b) Employee's Disability (as such term is defined in the Employment Agreement dated as of September 21, 2000 between Valley Financial Corporation and Employee, as the same may be amended from time to time (the "Employment Agreement"));
 - (c) Employee terminates his employment for Good Reason (as such term is defined in the Employment Agreement) or Employee's employment is terminated without Cause (as such term is defined in the Employment Agreement) so long as the Employment Agreement is in effect at such time.

6. After termination of this Agreement, all rights and benefits of Employee hereunder and under the Policy shall cease automatically.

7. At the death of the Employee, the proceeds of the Policy ("death proceeds") shall be paid in the following order: (a) the Employee's designated beneficiary or beneficiaries an amount equal to three times the Employee's base salary during the last full year of Employee's employment with Valley Bank ("Employee Proceeds"), and (b) the excess of the death proceeds after payment of the Employee Proceeds (the "Valley Bank Proceeds") to Valley Bank. In the event the total death proceeds are insufficient to pay the Employee Proceeds, Valley Bank shall not be obligated to make up and pay the difference to Employee's designated beneficiary or beneficiaries and the payment of the total death proceeds as provided herein shall constitute full and complete satisfaction of Valley Bank's obligations hereunder. Valley Bank agrees to direct the Insurer with respect to the payment of the death proceeds in accordance with this Agreement.

8. The Insurer shall be bound by the provisions of and endorsement on the Policy and shall be discharged from all claims, suits and demands under the Policy and the endorsement if and to the extent the Insurer complies with the same. The Insurer shall in no way be bound by this Agreement except to the extent the provisions of the Agreement are part of the Policy, including any endorsements.

9. Employee and Valley Bank may amend this Agreement, in whole or part, only by a writing executed by both Employee and Valley Bank.

10. This Agreement shall bind and insure to the benefit of the Employer and its successors and assigns; the Employee and his heirs, executors, administrators and assigns; and any Policy beneficiary.

11. The following provisions are part of this agreement and are intended to meet the requirements of the Employee Retirement Income Security Act of 1974:

- (a) The named fiduciary: Valley Bank
- (b) The funding policy under this Plan is that all premiums on the Policy will be remitted to the Insurer when due.
- (c) Direct payment by the Insurer is the basis of payment of benefits under this Plan, with those benefits in turn being based on the payment of premiums as provided in the Plan.
- (d) For claims procedure purposes, the "Claims Manager" shall be the Human Resources Committee of Valley Bank.
 - (1) If for any reason a claim for benefits under this Plan

is denied by Valley Bank, the Claims Manager shall deliver to the claimant a written explanation setting forth the specific reasons for the denial, pertinent references to the Plan section on which the denial is based, such other data as may be pertinent and information on the procedures to be followed by the claimant in obtaining a review of his claim, all written in a manner calculated to be understood by the claimant. For this purpose:

(A) The claimant's claims shall be deemed filed when presented orally or in writing to the Claims Manager.

(B) The Claims Manager's explanation shall be in writing delivered to the claimant within 90 days of the date the claim is filed.

(2) The claimant shall have 60 days following his receipt of the denial of the claim to file with the Claims Manager a written request for review of the denial. For such review, the claimant or his representative may submit pertinent documents and written issues and comments.

(3) The Claims Manager shall decide the issue on review and furnish the claimant with a copy within 60 days of receipt of the claimant's request for review of this claim. The decision on review shall be in writing and shall include specific reasons for the decision, written in a manner calculated to be understood by the claimant, as well as specific references to the pertinent Plan provisions on which the decision is based. If a copy of the decision is not so furnished to the claimant within 60 days, the claim shall be deemed denied on review.

12. Any notice, consent or demand required or permitted to be given under the provisions of the Agreement shall be in writing, and shall be signed by the party giving or making the same. If such notice, consent or demand is mailed to a party hereto, it shall be sent by United States certified mail, postage prepaid, addressed to such party's last known address as shown on the records of Valley Bank. The date of such mailing shall be deemed the date of notice, consent or demand.

13. This Agreement, and the rights of the parties hereunder, shall be governed by and construed in accordance with the laws of the State of Virginia.

IN WITNESS WHEREOF the parties have signed and sealed this agreement, as of the date first above written.

Valley Bank, a Virginia banking corporation

By: /s/ Ellis L. Gutshall
Ellis L. Gutshall
President and Chief Executive Officer

Attest:

Notary Public

Witness

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/s/ Kimberly B. Snyder

Kimberly B. Snyder

Section 5: EX-10.4 (FORM OF CHANGE IN CONTROL SEVERANCE AGREEMENT)

Exhibit 10.4

FORM OF CHANGE IN CONTROL SEVERANCE AGREEMENT

This Change in Control Severance Agreement (“Agreement”) is made and entered into as of November 1, 2008 between Valley Financial Corporation (“Company”), a Virginia corporation, and _____ (“Employee”).

WHEREAS, Employee is employed as _____ of Valley Bank (“Employer”) which is either the Company or a Subsidiary of the Company; and

WHEREAS, Company desires to provide Employee with certain benefits in the event that Employee’s employment with Employer is terminated under the circumstances specified in this Agreement;

WHEREAS, Employee desires to continue employment with Employer and to accept Company’s offer of the benefits specified in this Agreement;

NOW, THEREFORE, in consideration of the premises and mutual covenants and agreements hereinafter set forth, the parties hereto agree as follows:

SECTION 1. DEFINITIONS. As used in this Agreement, the following capitalized terms have the indicated meanings unless the context clearly requires otherwise:

1.01. “Applicable Federal Rate” has the meaning ascribed to that term in Section 1274(b)(2)(B) of the Code.

1.02. “Board” means the Board of Directors of the Company, unless otherwise specified.

1.03. “Cause” means (a) the continued failure (after notice from Employee’s supervisor or officer having superior authority over Employee) by Employee to perform his duties as an employee of Employer (other than any such failure resulting from his incapacity due to physical or mental illness); or (b) the violation of a lawful directive from Employee’s supervisor or officer having superior authority over Employee; or (c) a breach of Employee’s fiduciary duty; or (d) the engaging by the Employee in any conduct which has a material adverse financial effect on or is materially injurious to the Company or any Subsidiary and which was not done or omitted to be done in good faith and in the best interests of the Company or any Subsidiary; or (e) the engaging by Employee in any conduct which is illegal or dishonest either in connection with Employee’s duties as an employee of Employer or, if not so connected, which reflects in a materially adverse way on Employee’s fitness to serve in the capacity employed by Employer; or (f) the issuance of a removal order or similar order by a governmental regulatory agency with appropriate jurisdiction prohibiting Employee from participating in the affairs of the Company or any Subsidiary. For purposes of determining the existence of “Cause” under either clause 1.03(a) or 1.03(b) above any act or failure to act based upon authority given pursuant to a resolution duly adopted in the case of clause 1.03(a) above by the Board of Directors of the Employer or, in the case of clause 1.03(c) above, by the Board of Directors of either the Employer or the Company, if different, or, in the case of either clause 1.03(a) or 1.03(c) above, based upon the advice of counsel for the Company shall be conclusively presumed not to constitute “Cause”. In addition, Employee’s attention to matters not directly related to the business of the Employer shall not provide a basis for termination for Cause under either clause 1.03(a) or (c) above so long as either the Board of the Employer or Company, if different, has approved Employee’s engagement in such activities.

1.04. "Change in Control" means a change in control of a nature that would be required to be reported (assuming such event has not been "previously reported") in response to Item I(a) of the Current Report on Form 8-K, as in effect on the date hereof, pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended ("Exchange Act"); provided that, notwithstanding the foregoing and without limitation, such a change in control shall be deemed to have occurred at such time as (i) any person, within the meaning of Sections 3(a)(9) and 13(d)(3) of the Exchange Act ("Person") is or becomes the "beneficial owner" (as defined in Rule 13d-3 or Rule 13d-5 under the Exchange Act as in effect on January 1, 1994), directly or indirectly, of 20% or more of the combined voting power of the Company's voting securities; (ii) the Board as comprised on the date hereof (the "Incumbent Board") ceases for any reason to constitute at least the majority of the Board, provided that any person becoming a director subsequent to the date hereof whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least 75% of the directors comprising the Incumbent Board (either by a specific vote or by approval of the proxy statement of the Company in which such person is named as a nominee for director, without objection to such nomination) shall be, for purposes of this clause (ii) considered as though such person were a member of the Incumbent Board; (iii) all or substantially all of the assets of the Company or the assets of the Bank are sold, transferred or conveyed by any means, including but not limited to direct purchase or merger, if the transferee is not controlled by the Company, control meaning the ownership of more than 50% of the combined voting power of such entity's voting securities; or (iv) the Company is merged or consolidated with another corporation or entity and as a result of such merger or consolidation less than 75% of the outstanding voting securities of the surviving or resulting corporation or entity shall be owned in the aggregate by the former shareholders of the Company. Notwithstanding anything in the foregoing to the contrary, no change in control shall be deemed to have occurred for purposes of this Agreement by virtue of any transaction (i) which results in the Employee or a group of Persons which includes the Employee, acquiring, directly or indirectly, 20% or more of the combined voting power of the Employer's voting securities; (ii) arranged or caused by a federal bank regulatory agency possessing appropriate jurisdiction on the grounds of failing financial condition of the Company or Valley Bank which results in the acquisition, directly or indirectly, of 20% or more of the combined voting power of the Company's voting securities by any Person or (iii) which results in the Company, any Subsidiary of the Company or any profit-sharing plan, employee stock ownership plan or employee benefit plan of the Company or any of its subsidiaries (or any trustee or fiduciary with respect to any such plan acting in such capacity) acquiring, directly or indirectly, 20% or more of the combined voting power of the Company's voting securities.

1.05 "Code" means the Internal Revenue Code of 1986, as amended from time to time.

1.06 "Date of Termination" means the date of Employee's "separation from service" within the meaning of Code section 409A and Treasury Regulations thereunder.

1.07 "Disability" means the earlier of the following events: either (a) as a result of Employee's inability due to physical or mental illness, Employee shall have been absent from the full-time performance of his duties with the Employer for six (6) consecutive months, and (ii) within thirty (30) days after Notice of Termination is given Employee shall not have returned to the full-time performance of his duties; or (b) the Employee qualifies for full time disability benefits under any disability insurance policy provided by or through the Company as a Plan.

1.08 "Effective Date" means the date in the first paragraph of this Agreement.

1.09 "Employer" or "Company" includes any corporation or other entity which is the surviving or continuing entity in respect of any merger, consolidation or form of business combination in which the Employer or Company ceases to exist.

1.10 "Good Reason" means, on or after a Change in Control, (a) the failure by the Company to pay

Employee any compensation due Employee (which failure is not cured within 5 days after notice describing such failure and setting forth the amount owed); (b) a material diminution in the Employee's base compensation; (c) a material diminution in the Employee's authority, duties, title, or responsibilities, (d) a material change in the geographic location at which the Participant must perform the services, or (e) any other action or inaction that constitutes a material breach by the Company of this Agreement. Employee must provide notice to the Company of the existence of the condition on which a Good Reason termination would be based within sixty (60) days after the initial existence of the condition, upon the notice of which the Company shall have thirty (30) days during which it may remedy the condition without having to pay the amounts described in this Agreement.

1.11 "Notice of Termination" means a written notice that sets out the specific termination provision of this Agreement set forth in Section II relied upon for termination. No Notice of Termination is required hereunder in the event of the Employee's death.

1.12 "Plan" means any compensation plan such as an incentive, bonus, stock option or restricted stock plan, any pension or profit sharing plan or any welfare benefit plan (including, but not limited to health, life or disability insurance).

1.13 "Subsidiary" means any entity that the Company, directly or indirectly, has the practical ability to control.

SECTION 2. TERMINATION OF EMPLOYMENT AND SEVERANCE.

2.01 Termination Not Providing for Severance. Upon termination of employment after the Effective Date: (a) by the Employee for other than Good Reason; or (b) by the Employer for Cause; or (c) by the Employer for any reason prior to a Change in Control; or (d) by the Employer on account of Employee's Disability; or (e) by virtue of Employee's death, the Company shall pay or cause to be paid to the Employee an amount equal to Employee's accrued salary through the Date of Termination at the rate in effect at the time Notice of Termination is given (if required). Employee shall not be entitled to any bonus or other discretionary compensation which has not been received by Employee prior to the Notice of Termination unless provided for under the specific terms of any Plan. In the event of Employee's death and the foregoing amounts shall be determined on the date of death without any requirement for Notice of Termination. Notwithstanding any other provision of this Agreement, the severance pay described in Section 2.02 below shall not be payable upon termination of Employee's employment for any reason before a Change in Control.

2.02 Termination Providing for Severance. Upon termination of Employee's employment on or after a Change in Control, if such termination is not one of the types described in Section 2.01, the Company shall pay or cause to be paid to Employee (in addition to the amount determined under Section 2.01) an amount equal to two (2) times the Employee's annual salary at the rate in effect (i) at the time Notice of Termination is given, if Notice of Termination is required, or (ii) on the Date of Termination, if no Notice of Termination is required. Such payment shall be made within thirty (30) days of the Date of Termination, if Employee is not a "specified employee" for purposes of Code Section 409A on the Date of Termination. If Employee is a "specified employee" for purposes of Code Section 409A on the Date of Termination, the payment shall be made (i) within thirty (30) days of the Date of Termination to the extent the payment is permitted to be treated as exempt "separation pay" for purposes of Code Section 409A and Treasury Regulations thereunder; and (ii) on the first day of the month following the six-month anniversary of the Date of Termination to the extent the payment is not permitted to be treated as exempt "separation pay" for purposes of Code Section 409A and Treasury Regulations thereunder. If such payment is required to be made on the first day of the month following the six-month anniversary of the Employee's Date of Termination, interest shall accrue on the payment from Employee's Date of Termination through the date of payment at the Prime Rate of Interest in effect on the Date of Termination and

as reported in the Wall Street Journal.

2.03 Offset and Recovery. The amount of any payment provided for in this Section II shall not be reduced, offset or subject to recovery by the Company by reason of any compensation earned by Employee as the result of employment by another employer after the Date of Termination, or otherwise but any sums paid to Employee hereunder which were not properly payable to such Employee may be recovered by or in right of the Company, together with interest at the Applicable Federal Rate.

SECTION 3. TERM; BINDING AGREEMENT.

3.01 This Agreement shall continue in effect until the first anniversary of the Effective Date; provided, however, that beginning with the first anniversary of the Effective Date and each anniversary thereafter, the term of this Agreement shall automatically be extended for one additional year unless at least one hundred twenty (120) days prior to such anniversary date, the Company or the Employee shall have given written notice that this Agreement shall not be extended, and provided further, anything in this Agreement to the contrary notwithstanding, this Agreement shall continue in effect for at least a period of twelve (12) months beyond the date of a Change in Control, if one shall have occurred (i) during the term of this Agreement, and (ii) prior to a Notice of Termination, except a Notice of Termination given by the Company other than for Cause or Disability after any regulatory filing has been made in contemplation of a Change in Control.

3.02 This Agreement shall be binding upon and inure to the benefit of and be enforceable by Employee's personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees; provided that the Employee may not assign this Agreement or any right hereunder without the express prior written consent of the Company. This Agreement shall be binding upon and (in addition to the intended third party beneficiaries pursuant to Section 11) inure to the benefit of the Company and its successors and assigns, whether by merger, consolidation or transfer of all or substantially all of the Company's assets, in which case the "Company" as used herein shall mean such successor or assignee.

SECTION 4. FEES AND EXPENSES.

4.01 Except as provided in Section 7, each party shall pay its own legal fees and related or other expenses incurred in connection with this Agreement including, without limitation all such fees and expenses, if any, incurred in contesting or disputing any termination or seeking to obtain or enforce any right or benefit provided by this Agreement, whether or not such party prevails.

SECTION 5. TAXES.

5.01 All payments to be made to Employee under this Agreement will be subject to required withholding of federal, state and local and employment and other taxes.

SECTION 6. MISCELLANEOUS.

6.01 Survival. The respective obligations of, and benefits afforded to, the parties in Sections 2, 4, 5, 6, 7, 10, and 11 of this Agreement shall survive termination of this Agreement.

6.02 Notice. For the purposes of this Agreement, notices and all other communications provided for in the Agreement shall be in writing and shall be deemed to have been duly given by Company when delivered to Employee or by Employee when delivered to the President/Chief Executive Officer of Company or when mailed by United States registered mail, return receipt requested, postage prepaid and addressed, in the case of Company, to the attention of the President/Chief Executive Officer at the following address:

Valley Financial Corporation
36 Church Avenue, SW
Roanoke, Virginia 24011

or, in the case of Employee, to the address set forth below the Employee's signature, provided that all notices may be sent to such other address as either party may have furnished to the other in writing in accordance herewith, except that notice of change of address shall be effective only upon receipt.

6.03 Modification; Waiver; Governing Law. No provision of this Agreement may be modified, waived or discharged unless such modification, waiver or discharge is agreed to in writing signed by Employee and the President/Chief Executive Officer of Company. No waiver by either party hereto at any time of any breach by the other party hereto of, or compliance with, any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of a similar or dissimilar provisions or conditions at the same or at any prior or subsequent time. No agreements or representations, oral or otherwise, express or implied, with respect to the subject matter hereof have been made by either party which are not expressly set forth in this Agreement. The validity, interpretation, construction and performance of this Agreement shall be governed by the laws of the Commonwealth of Virginia (excluding its principles of conflict of laws).

6.04 Validity. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision of this Agreement, which shall remain in full force and effect.

6.05 Jurisdiction and Venue and JURY WAIVER. All disputes and legal or other litigation proceedings by any party hereto in connection with or relating to this Agreement, in whole or part, its enforcement or any matters described or contemplated herein shall be instituted only in the courts of Virginia or of the United States sitting in Virginia. Each party promises to commence any legal proceeding only in such courts and each party irrevocably submits to the exclusive jurisdiction of such courts in any such disputes or litigation. Each party irrevocably waives the rights to trial by jury in connection with any matter arising hereunder to the fullest extent permitted by law, any defense or objection it may now or hereafter have to the laying of venue of any such proceeding brought in such courts and any claim that any proceeding brought in any such courts has been brought in an inconvenient forum.

6.06 At Will Employment. Employee acknowledges and agrees that Employee is an "at-will" employee and nothing herein or in any general or specific written or oral policies of Company or Employer or statements made to Employee at any time, whether written or oral or any assignment of "Due Cause" to any action or inaction of Employee shall or shall be deemed to change or restrict this at-will relationship.

SECTION 7. CONFIDENTIALITY; COVENANT NOT TO COMPETE.

7.01 Confidentiality. Employee agrees that during and subsequent to his period of employment with Employer, Employee will not at any time communicate or disclose to any person or entity, without the consent of the Company or Employer (which shall be in writing if after termination of employment) or use or take benefit from or assist any other person or entity to use or benefit from, any proprietary or other confidential information concerning the Company or any Subsidiary of the Company, their joint and several operations, assets, personnel, finances, business methodologies, policies, procedures and plans and strategies, it being understood, however, that the obligations of this Section shall not apply to the extent that the aforesaid matters (a) are disclosed in circumstances where Employee is legally required to do so or (b) become generally known to and available for use by the public otherwise than by the Employee's act or omission.

7.02 Covenant Not to Compete. If the Employee's employment with the Employer is terminated under circumstances entitling Employee to severance compensation under Section 2.2 of this Agreement, the Employee

agrees that for a period of 2 (two) years from the date employment is terminated, Employee will not, without the prior, written consent of the President/Chief Executive Officer of the Company, become an officer, employee, agent, partner, director, or substantial stockholder of any entity engaged in the commercial or retail banking business within a 100 mile radius of the City of Roanoke, Virginia, or become associated in any substantial manner with any entity in the process of formation to engage in the retail or commercial banking business, or any group that intends to form any such entity in the geographical area described above.

7.03 Relief. In the event of Employee's actual or threatened breach of this Section, the Company and/or Employer shall be entitled to a preliminary restraining order and an injunction restraining the Employee from violating its provisions. Notwithstanding Section 4, in the event the Employee is in breach of this Section, Employee shall be liable for all costs and expenses incurred by the Company and/or Employer, including but not limited to reasonable legal fees and expert witness fees, in obtaining any equitable or legal relief in connection with such a breach.

7.04 Other Remedies. Nothing in this Agreement shall be construed to prohibit the Company or Employer from pursuing any other available remedies for such breach or threatened breach, including the recovery of damages from the Employee. If at the time of enforcement of this Section a court holds that the duration, scope or area restrictions stated herein are unreasonable under the circumstances then existing and, thus, unenforceable, the Company and Employee agree that the maximum duration, scope or area reasonable under such circumstances shall be substituted for the stated duration, scope or area.

SECTION 8. RELATED AGREEMENTS.

8.01 To the extent that any provision of any other agreement between Company or any of its Subsidiaries and Employee shall limit, qualify or be inconsistent with any provision of this Agreement, then for purposes of this Agreement, while such other agreement shall remain in force, the provision of this Agreement shall control and such provision of such other agreement shall be deemed to have been superseded, and to be of no force or effect, as if such other agreement had been formally amended to the extent necessary to accomplish such purpose.

SECTION 9. COUNTERPARTS.

9.01 This Agreement may be executed in several counterparts, each of which shall be deemed to be an original but all of which together will constitute one and the same instrument.

SECTION 10. RELEASE.

10.01 Notwithstanding anything in this Agreement to the contrary, in order to be eligible to receive any payments or benefits (including but not limited to any severance payment) under this Agreement in addition to fulfilling all other conditions precedent to the same, Employee (if he has the legal capacity or if not, Employee's legal representative) must within 10 days after the Date of Termination: (a) resign as a member of the Board of the Company and its Subsidiaries, if applicable, and as an officer, manager and employee of the Company and its Subsidiaries and (b) execute, on behalf of Employee and Employee's estate, heirs and representatives, a release in form and substance satisfactory to the Company and its legal counsel releasing the Company and its Subsidiaries and their respective officers, directors, employees, members, managers, agents, independent contractors, representatives, shareholders, successors and assigns from any and all claims related to the termination of Employee's employment.

SECTION 11. THIRD PARTY BENEFICIARIES.

11.01 Employer is an intended third party beneficiary of the rights and benefits of Section 7, with full power to enforce in its own name alone or in conjunction with Company.

11.02 The Company and its Subsidiaries and their respective officers, directors, employees, members, managers, agents, independent contractors, representatives, shareholders, successors and assigns are each intended third party beneficiaries of the rights and benefits of Section 10, with full power to enforce in their own name alone or in conjunction with the Company or any other third party beneficiary.

IN WITNESS WHEREOF, the parties have executed this Agreement as of November 12, 2008.

VALLEY FINANCIAL CORPORATION

By: /s/ Ellis L. Gutshall

Ellis L. Gutshall, President and CEO

Employee:

Address:

Schedule to Form of Change in Control Agreement

<u>Employee</u>	<u>Title</u>
John T. McCaleb	Executive Vice President and Chief Lending Officer
Andrew M. Agee	Senior Vice President and Senior Real Estate Officer

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Section 6: EX-10.5 (FORM OF AMENDED SUPPLEMENTAL RETIREMENT PLAN)

EXHIBIT 10.5

THIS SUPPLEMENTAL RETIREMENT PLAN (hereinafter the “Plan”) is adopted by Valley Bank, a State Banking Corporation, organized and existing under the laws of the Commonwealth of Virginia (hereinafter sometimes referred to as the “Bank” and sometimes referred to as the “Plan Sponsor”) effective November 1, 2008. The Plan is an amendment and restatement of several individual supplemental retirement plans (the “Individual Plans”), adopted prior to November 1, 2008, and consolidated as part of the Plan. The Plan is intended to comply with the requirements of Section 409A of the Internal Revenue Code of 1986 (the “Code”) and final regulations thereunder. The Individual Plans have been operated in good faith compliance with the requirements of Section 409A of the Code for periods from January 1, 2005, through December 31, 2008.

ARTICLE I Definition of Terms

The following words and terms as used in this Plan shall have the meaning set forth below, unless a different meaning is clearly required by the context:

1.1 “Act”: The Employee Retirement Income Security Act of 1974, as the same may be amended from time to time, or the corresponding sections of any subsequent legislation which replaces it, and, to the extent not inconsistent therewith, the regulations issued thereunder.

1.2 “Administrator”: The plan administrator provided for in Article VIII hereof.

1.3 “Bank”: Valley Bank, a bank organized under the laws of the Commonwealth of Virginia.

1.4 “Affiliate”: Any subsidiary, affiliate or other related business entity to the Corporation.

1.5 “Beneficiary”: The person or persons designated by Participant or otherwise entitled pursuant to Article IV to receive benefits under the Plan attributable to such Participant after the death of such Participant.

1.6 “Board”: The present and any succeeding Board of Directors of the Bank.

1.7 “Change of Control”: A change in control of a nature that would be required to be reported (assuming such event has not been “previously reported”) in response to Item 1(a) of the Current Report on Form 8-K, as in effect on the date hereof, pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended (“Exchange Act”); provided that, notwithstanding the foregoing and without limitation, such a change in control shall be deemed to have occurred at such time as:

(i) any Person is or becomes the “beneficial owner” (as defined in Rule 13d-3 or Rule 13d-5 under the Exchange Act as in effect on January 1, 1994), directly or indirectly, of 20% or more of the combined voting power of the Corporation’s voting securities;

(ii) individuals who as of the date hereof, constitute the Board of Directors of the Corporation (the “Incumbent Board”) ceases for any reason to constitute at least the majority of the Board, provided that any person becoming a director subsequent to the date hereof whose election, or nomination for election by the Corporation’s shareholders, was approved by a vote of at least 75% of the directors comprising the Incumbent Board (either by a specific vote or by approval of the proxy statement of the Corporation in which such person is named as a nominee for director, without objection to such nomination) shall be, for the purposes of this clause (ii) considered as though such person were a member of the Incumbent Board;

(iii) all or substantially all of the assets of the Corporation or the assets of the Bank are sold, transferred or conveyed by any means, including but not limited to direct purchase or merger, if the transferee is not controlled by the Corporation with “control” for the purposes of this subsection meaning the ownership of more than 50% of the combined voting power of such entity’s voting securities; or

(iv) the Corporation is merged or consolidated with another corporation or entity and as a result of such merger or consolidation less than 75% of the outstanding voting securities of the surviving or resulting corporation or entity shall be owned, in the aggregate, by the former shareholders of the Corporation.

Notwithstanding anything in the foregoing to the contrary, no change in control shall be deemed to have occurred for purposes of this Agreement by virtue of any transaction.

(i) which results in Participant or a group of Persons which includes participant, acquiring, directly or indirectly, 20% or more of the combined voting power of the Corporation’s voting securities;

(ii) arranged or caused by a federal bank regulatory agency possessing appropriate jurisdiction on the grounds of failing financial condition of the Corporation or Bank which results in the acquisition, directly or indirectly, of 20% or more of the combined voting power of the Corporation’s voting securities by any Person; or

(iii) which results in the Corporation, any subsidiary of the Corporation or any profit-sharing plan, employee stock ownership plan or employee benefit plan of the Corporation or any of its subsidiaries (or any trustee of or fiduciary with respect to any such plan acting in such capacity) acquiring, directly or indirectly, 20% or more of the combined voting power of the Corporation’s voting securities.

1.8 “Code”: The Internal Revenue Code of 1986, as the same may be amended from time to time, or the corresponding section of any subsequent Internal Revenue Code, and, to the extent not inconsistent therewith, regulations issued thereunder.

1.9 “Corporation”: Valley Financial Corporation, the parent corporation owning the Bank.

1.10 “Delayed Retirement Date”: In the event Participant continues in the active employment of the Bank beyond his Normal Retirement Date, the first day of the calendar month next following the date of termination of his employment with the Bank.

1.11 “Disability Retirement Date”: The first day of the calendar month coinciding with or the next following the date Participant retires as a result of a Disability. For purposes hereof, the existence of a “Disability” or the status of being “Disabled” shall be considered present during the period for which Participant either:

(i) is determined by the Federal Social Security Administration to be disabled, as that term is defined for purposes of the Federal Social Security disability benefits, and for which he receives such benefits after the required waiting period prior to his Normal Retirement Date, or

(ii) is determined by the applicable fiduciary to be disabled for purposes of entitlement to disability benefits under any long term disability plan which is maintained by the Bank and under which Participant is covered, and for which Participant receives such benefits prior to his Normal Retirement Date for a period of not less than three months,

provided the cause of such Disability occurred when Participant was participating in this Plan. The Administrator shall have the right to require proof of continuing Disability. Failure by Participant to provide such evidence as may, from time to time, be required by the Administrator prior to Participant’s attainment of his Normal Retirement Date shall result in the discontinuance of his Disability Retirement status and the termination of his/her status as Disabled under the Plan. The determination of Disability shall be made by the Administrator in accordance with standards uniformly applied to all other employees of the Bank participating in similar plans, on the advice of one or more physicians appointed or approved by the Bank if deemed necessary or advisable by the Administrator, and the Administrator shall have the right to require further medical examinations from time to time to determine whether there has been any change in the Participant’s physical condition.

1.12 “Effective Date”: The Effective Date of the Plan, as amended and restated, is November 1, 2008.

1.13 “Normal Retirement Date”: The first day of the calendar month coinciding with or next following date on which the Participant attains age sixty-five (65).

1.14 “Participant”: An employee of the Bank or an Affiliate selected to participate in the Plan in accordance with Article II.

1.15 “Participation Date”: The date of an individual’s entry into the Plan as a Participant in accordance with Article II.

1.16 “Plan”: This document as contained herein or duly amended, which reflects a consolidation and amendment and restatement of the individual supplemental retirement plans identified on Exhibit 1.16, attached hereto.

1.17 “Plan Sponsor”: Valley Bank, a state bank.

1.18 “Plan Year”: A twelve (12) month period commencing on January 1 and ending on December 31 of each year.

1.19 “Retirement Benefit”: The amount due Participant or his designated Beneficiary under the Plan, as determined pursuant to Article III hereof.

1.20 “Separation for Service”: Except as provided below, Separation from Service means either: (i) the complete cessation of the performance of services by the Participant for the employer for whatever reason, or (ii) a diminished level of services where the Participant is expected to perform services at a level equal to 20% or less of the average level of service provided during the immediately preceding 36 months.

Separation from Service does not include military leave, sick leave or other bona fide leave of absence if (i) the period of such leave does not exceed six months, and (ii) there is a reasonable expectation that the Participant will return to perform service with the employer. There is a deemed Separation from Service if the leave of absence exceeds six months and the Participant has no contractual or statutory right to reemployment. Such deemed Separation of Service occurs on the first day immediately following the six month period. A 29-month period shall be substituted for the six-month period if the leave of absence is due to a medically determinable physical or mental impairment expected to result in death or last for a continuous period of six months or more. For purposes of this Section 1.20, “employer” means “employer” as defined in the Treasury Regulations Section 1.409A-1(h)(3).

1.21 “Specified Employee”: A Participant who, as of December 31st of a calendar year, meets the requirements of Code section 416(i)(1)(A)(i), (ii), or (iii) applied in accordance with the regulations thereunder and disregarding Code section 416(i)(5). A Participant who meets the criteria in the preceding sentence will be considered a Specified Employee for purposes of the Plan for the 12-month period commencing on the next following April 1. Compensation for purposes of identifying the Specified Employee is

defined according to Treasury Regulations section 1.415(c)-2(a) applied without regard to the safe harbor provided in Treasury Regulations section 1.415(c)-2(d), the special timing rules provided in Treasury Regulations section 1.415(c)-2(e), and the special rules provided in Treasury Regulation section 1.415(c)-2(g).

ARTICLE II
Eligibility for Benefits

2.1 Eligibility and Date of Participation. The Board in its discretion shall designate whether and when an employee is eligible to participate in the Plan. The Board shall designate Participants from among those individuals who constitute a select group of management or highly compensated employees of the Bank or an Affiliate for purposes of the Employee Retirement Income Security Act of 1974, as amended; provided, however, that the Board need not designate as Participants all such individuals. A Participant shall be eligible to receive a benefit determined under Article III of this Plan following his termination of employment with the Plan Sponsor in the event such termination occurs following his Normal Retirement Date, Disability or termination of his employment for any reason following completion of the required years of service set forth herein below in Article V, said payment of benefits to be paid in accordance with the provisions of Article VI.

ARTICLE III
Supplemental Retirement Benefit

3.1 Determination of Supplemental Retirement Benefit.

3.1(a) Subject to the terms and conditions set forth herein, upon Participant's termination of employment on or after his Normal Retirement Date he/she shall be entitled to a yearly benefit equal to fifty percent (50%) of the Participant's final five (5) years average Compensation, reduced by Participant's primary Social Security benefit. In the event Participant's Normal Retirement Date shall occur earlier than fifteen (15) years from the Participant's Participation Date, Participant's yearly benefit shall be reduced by a **Fraction**, the **Numerator** of which shall be Participant's years of employment with the Bank or the Corporation from the Participant's Participation Date until his Normal Retirement Date and the **Denominator** of which shall be fifteen (15) (hereinafter referred to as the "Target Retirement Benefit").

"Example: yearly benefit x Years of employment from Participation Date to Normal Retirement Date)

The Target Retirement Benefit shall be subject to such increase or decrease as may be determined in accordance with Section 3.1(b) below or Section 5.1(b) if employment terminates prior to Participant's Normal Retirement Date. The Target Retirement Benefit shall be paid in monthly installments for a period of one hundred and eighty (180) months.

3.1(b) The Bank shall establish for the benefit of Participant a separate account for bookkeeping purposes and shall credit to such account for each Plan Year an amount that when aggregated with similar accruals for all Plan Years prior to Participant's Normal Retirement Date is projected to fully fund the Target Retirement Benefit. The amount required each Plan Year to fully fund the Target Retirement Benefit for the Participant at his Normal Retirement Date shall be referred to herein as the "Target Annual Accrual."

In order to ensure that the Supplemental Retirement Benefit to be paid Participant at his Normal Retirement Date properly reflects the financial performance of the Corporation during the period of Participant's participation in the Plan, the Target Annual Accrual amount for a Participant shall be subject to increase or decrease each Plan Year based upon the average of the percentages (i.e., 50%, 80%, 100%, 110%, or 125%) that were earned pursuant to the chart below for the fiscal year of the Corporation immediately preceding the Plan Year for which the Target Annual Accrual is to be determined, as well as for each prior fiscal year during the period of Participant's participation in the Plan. The measure of the Corporation's financial performance shall be its Return on Equity ("ROE") as determined for the most recent fiscal year of the Corporation immediately preceding the Plan Year in which the determination of the Target Annual Accrual is to be made. The Corporation's ROE shall be determined by the Corporation's auditors or certified public accountant on a consistent basis.

The "Target Annual Accrual" shall be increased or decreased each Plan Year based upon the following ROE requirements for the Corporation's preceding fiscal year:

<u>Under 10% ROE</u>	<u>10%-12% ROE</u>	<u>12%-15% ROE</u>	<u>15%-18% ROE</u>	<u>Over 18% ROE</u>	
50%					50% of Target Annual Accrual
	80%				80% of Target Annual Accrual
		100%			100% of Target Annual Accrual
			110%		110% of Target Annual Accrual
				125%	125% of Target Annual Accrual

Notwithstanding the foregoing, the Administrator shall, on a prospective basis only, have the right to make adjustments to the ROE requirements set forth above at any time during the term of this Plan.

EXAMPLE: If the Corporation's ROE for fiscal year previous to year 1 of the Plan is 10%-12%, the amount credited to Participant's Account for year 1 of the Plan shall be 80% of the Target Annual Accrual amount for such year. If, in year 2, the ROE for the previous fiscal year is 15%-18%, the amount credited to Participant's account in year 2 shall be $(110\% + 80\%/2)$ times the Target Annual Accrual for such year.

At Normal Retirement, Participant's Supplemental Retirement Benefit to be paid in accordance with Article VI shall be the Target Retirement Benefit increased or reduced as a result of any adjustments to the Target Annual Accruals to his account based upon the annual ROE requirements for the Corporation.

For the purposes of determining the Supplemental Retirement Benefit due a Participant under this Plan, the assumptions to be used by the Administrator shall be those set forth for that Participant in Exhibit 3.1(b), which shall be deemed a part of this Plan.

3.1(c) Notwithstanding the foregoing, if Participant terminates employment prior to his Normal Retirement Date, the benefit calculated under this Article III may be subject to adjustment in accordance with the vesting schedule set forth in Article V below.

3.2 Definitions. For purpose hereof, the following terms shall have the following meaning:

3.2(a) “Compensation” shall, for the purpose of projecting Participant’s Target Retirement Benefit mean Participant’s total base salary, wages, and bonus received by or made available to him by the Bank for a Fiscal Year. Compensation shall be determined for Participant prior to any withholding or deductions and prior to any reduction for employee elective contributions to a Cafeteria Plan described in Section 125 of the Code or a qualified cash or deferred arrangement described in Section 401(k) of the Code. However, Compensation shall exclude items of compensation as expense reimbursements and allowances, amounts contributed to or on behalf of Participant pursuant to this Plan or any other employee benefit plan or program of the Bank or Corporation in which Participant is eligible to participate, or any other similar extraordinary remuneration.

3.2(b) “Primary Social Security Benefit” means the annual income to which Participant is entitled at normal retirement under the provisions of the Federal Social Security Act as in effect on the first day of the Plan Year in which he attains age sixty-six (66). If Participant does not qualify for, or loses, Social Security benefits to which he is entitled under the Federal Social Security Act because of failure to make application therefore, or for any other reason, such Social Security benefits shall nevertheless be considered, for purposes of the Plan, as being received by Participant. It is the intent of this definition that Participant’s Supplemental Retirement Benefit shall be offset by the actual social security benefits payable at that time. If Participant begins to receive the social security benefits earlier, such paid benefits will be used as an offset, and the offset will reflect the fact that the actual payments to the Participant are less (because of the early payment) than the social security benefits used to determine the offset.

ARTICLE IV Death Benefit

4.1 Death after Commencement of Payment. If Participant dies after his Supplemental Retirement Benefit commences to be paid and before Participant has received one hundred eighty (180) monthly payments, the only benefits payable under the Plan to his Beneficiary after his death shall be the remaining monthly payments needed to ensure that one hundred eighty (180) monthly payments are made.

4.2 Supplemental Death Benefit.

4.2(a) If Participant dies before his Normal Retirement Date and provided that Participant has designated a Beneficiary in anticipation of death, a Supplemental Death Benefit shall be paid to the Beneficiary in an annual amount equal to the excess of:

- (i) Fifty percent (50%) of the Participant's Compensation, (as defined in subparagraph 3.2), for the calendar year immediately preceding the year in which Participant's death occurs, over
- (ii) The Social Security Survivor Benefit.

The Supplemental Death Benefit shall be paid each year in twelve (12) monthly installments for a period of one hundred and eighty (180) months commencing on the first day of the month following Participant's death. The Supplemental Death Benefit shall be paid in lieu of any Supplemental Retirement Benefit.

4.3 Beneficiary Designation.

4.3(a) Participant shall be entitled to designate a Beneficiary hereunder by filing a designation in writing with the Administrator on the form provided for such purpose. Any Beneficiary designation made hereunder shall be effective only if signed and dated by Participant and delivered to the Administrator prior to the time of Participant's death. Any Beneficiary designation hereunder shall remain effective until changed or revoked hereunder.

4.3(b) Any Beneficiary designation may include multiple, contingent or successive Beneficiaries and may specify the proportionate distribution to each Beneficiary.

4.3(c) A Beneficiary designation may be changed by Participant at any time, or from time to time, by filing a new designation in writing with the Administrator.

4.3(d) If Participant dies without having designated a Beneficiary, or if the Beneficiary so designated his predeceased him/her, then his/her estate shall be deemed to be his/her Beneficiary.

4.3(e) If a Beneficiary of Participant shall survive Participant but shall die before the Participant's entire benefit under the Plan has been distributed, then, absent any other provision by Participant, the unpaid balance thereof shall be distributed to the such other beneficiary named by the decreased Beneficiary to received his/her interest or if none, to the estate of the decreased Beneficiary. If multiple beneficiaries are designated, absent any other provision by the Participant, those named or the survivor of them shall share equally any amounts payable hereunder.

ARTICLE V
Vesting Schedule

5.1 Vesting Generally

5.1(a) Except as set forth below and subject to the forfeiture events described in paragraph 5.2 hereof, Participant shall be fully vested in his/her Supplemental Retirement Benefit upon the first to occur of:

- (i) A Participant's having reached his Normal Retirement Date while employed by the Bank or the Corporation,
- (ii) A Participant's having remained continuously employed with the Bank and/or the Corporation through the end of the first fiscal year for which a 100% "Vested %" is shown on the schedule for that Participant attached as **Exhibit 5.1(b)**; or
- (iii) The occurrence of a Change of Control.

5.1(b) Separation from Service Prior to Normal Retirement Date.

Absent an event described in Section 5.1(a) and 5.2, a Participant shall, following a voluntary Separation from Service, be entitled to receive the vested portion of his Supplemental Retirement Benefit as determined in Section 3.2 above in accordance with the vesting schedule for that Participant attached as **Exhibit 5.1(b)**.

The payment of Supplemental Retirement Benefits for a Participant who Separates from Service prior to Normal Retirement Date shall be payable in accordance with the provisions of Article VI herein below.

5.1(c) Separation from Service Due to Disability.

In the event of a Participant's Separation from Service on his Disability Retirement Date on account of Disability, such Participant will have a vested right to the Supplemental Retirement Benefit described in section 3.1(a) in an amount equal to the greater of:

- (i) 25%; or
- (ii) the actual vested amount for such Participant based the vesting schedule for that Participant attached as **Exhibit 5.1(b)**.

Solely for purposes of determining Participant's final five (5) years average Compensation in order to compute the benefit payable to him/her under this section 5.1(c), the Participant's Disability Retirement Date shall be deemed to be the Participant's Normal Retirement Date. The Supplemental Retirement Benefit payable to Participant as a result of his Disability shall begin on the Participant's Normal Retirement Date and shall be paid in accordance with the provisions of Article VI set forth below.

5.2 Forfeiture of Benefits.

5.2(a) Notwithstanding any contrary provision hereof, Supplemental Retirement with respect to Participant shall be forfeited upon the occurrence of any of the following:

- (i) Participant's voluntary termination of employment prior to meeting the vesting requirements of Section 5.1(b);
- (ii) Participant's termination of employment with the Bank for "cause";
- (iii) Participant's entering "competition", his/her making an "unauthorized disclosure of confidential information", after his termination of or retirement from employment with the Bank, in which case all payments to or with respect to Participant shall cease and all payments made to Participant or his Beneficiary under the Plan since the occurrence of such event of forfeiture shall be returned to the Bank (provided however, forfeiture shall not occur upon Participant's entering into competition following a Change of Control); or
- (iv) The discovery by the Bank following Participant's termination of or retirement from employment with the Bank or following his death, that an event constituting "cause" sufficient for his termination of employment or discovery of Participant's previous "unauthorized disclosure of confidential information" prior to his termination, retirement, or death before termination or retirement, in which case all payments under the Plan to or with respect to Participant shall cease and all payments previously made to Participant or his Beneficiary under the Plan shall be returned to the Bank.

All determinations relative to the forfeiture of Supplemental Retirement Benefits hereunder shall be made by the Board of Directors of the Company.

5.2(b) For purposes of this Section 5.2:

(i) "Cause" means (i) the willful and continued failure by Participant to substantially perform his duties as an employee (other than any such failure resulting from his/her incapacity due to physical or mental illness) after a written demand for substantial performance is delivered to Participant by (a) the Board (excluding Participant), where Participant is the Chief Executive Officer of the Corporation, or (b) the Chief Executive Officer of the Corporation or his delegate, for any other Participant, and which failure has not been cured as hereinafter provided, which demand specifically identifies the manner in which the board believes that Participant has not substantially performed his duties, or (ii) the willful engaging by Participant in illegal conduct or any conduct which is demonstrably and materially injurious to the Corporation or Bank. Without limiting the generality of the foregoing, Cause shall include the issuance of a removal order or similar order by a governmental regulatory agency with appropriate jurisdiction prohibiting Participant from participating in the affairs of the Corporation or Bank. Any act or failure to act based upon authority given pursuant to a resolution duly adopted by the Board of the Corporation or Bank Board or based upon the advice of counsel for

the Corporation or Bank shall be conclusively presumed to be done, or omitted to be done, by Participant in good faith and in the best interests of the Corporation and Bank. It is also expressly understood and acknowledged by the parties that the Participant's attention to matters not directly related to the business of the Corporation or Bank shall not provide a basis for termination for Cause so long as the Corporation and/or Bank has approved participant's engagement in such activities. Upon the issuance of a written demand for substantial performance, Participant shall have a reasonable period of time in which to correct such alleged violation, provided, however, that the alleged violation is neither dishonest nor criminal. The parties acknowledge and agree that thirty (30) days shall be deemed a reasonable time in which to correct any such alleged violation. If Participant is unable to correct the alleged violation within said thirty (30) day period, then if (a) the Board (excluding Participant, where Participant is the Chief Executive Officer of the Corporation, or (b) the Chief Executive Officer of the Corporation or his delegate, for any other Participant, determines that Participant is using his best efforts to make such correction and that the alleged violation can be corrected, the Board, Chief Executive Officer or delegate, as applicable, shall extend the thirty (30) day period by such time as is reasonably necessary for Participant to effect such correction as expeditiously as practicable. Notwithstanding the foregoing, after a Change in Control of the Corporation or the Bank, Participant shall not be deemed to be terminated for Cause unless and until there shall have been delivered to Participant a copy of a resolution duly adopted by the affirmative vote of not less than 75% of the entire membership of the Board (excluding Participant) at a meeting of such Board called and held for such purpose (after a reasonable notice to Participant and an opportunity for Participant, together with his/her counsel, to be heard before the board), finding that in the good faith opinion of the Board Participant was guilty of conduct set forth above and specifying the particulars thereof in detail. In such event Participant shall have a reasonable period of time in which to correct the alleged violation, provided, however, that the alleged violation is neither dishonest nor criminal. As in the case of an alleged violation prior to a Change in Control, it is agreed that thirty (30) days (extended by the Board, if necessary, as outlined above) shall be deemed a reasonable time in which to correct any such alleged violation.

(ii) "Competition" means engaging by Participant, without the written consent of the Board, or a person authorized hereby, in a business as a more than one percent (1%) stockholder, an officer, a director, an employee, a partner, an agent, a consultant, or any other individual or representative capacity (unless Participant's duties, responsibilities, and activities, including supervisory activities, for or on behalf of such business, are not related in any way to such competitive activity) if it involves:

(A) Engaging in, or entering into services or providing advice pertaining to, any line of business that the Bank, the Corporation or any Affiliate actively conducts or develops in competition with the Bank, the Corporation or any Affiliate in the same geographic area (generally, within a one hundred (100) mile radius of Roanoke, Virginia) as such line of business is then conducted, or

(B) Soliciting for employment any employees of the Bank, the Corporation or any Affiliate.

(iii) "Unauthorized disclosure of confidential information" means the disclosure by Participant, without the written consent of the Board or a person authorized thereby, to any person other than as required by law or court order, or other than to an authorized employee of the Bank, the Corporation or an Affiliate, or to a person to whom disclosure is necessary or appropriate in connection with the performance by Participant of his duties as an employee or director of the Bank, the Corporation or an Affiliate (including, but not limited to, disclosure to the Corporation's or an Affiliate's outside counsel, accountants, or bankers of financial data properly requested by such persons and approved by an authorized officer of the Bank or the Corporation), any confidential information of the Bank or the Corporation or any Affiliate with respect to any of the products, services, customers, suppliers, marketing techniques, methods or future plans of the Bank, the Corporation or any Affiliate; provided, however, that:

(A) Confidential information shall not include any information known generally to the public (other than as a result of unauthorized disclosure by Participant) or any information of a type not otherwise considered confidential by persons engaged in the same business or a business similar to that conducted by the Bank, the Corporation, or any Affiliate; and

(B) Participant shall be allowed to disclose confidential information to his attorney solely for the purpose of ascertaining whether such information is confidential within the intent of the Plan, but only so long as Participant both discloses to his attorney the provisions of this paragraph and agrees not to waive the attorney-client privilege with respect thereto.

ARTICLE VI

Payment of Benefits

6.1 Time and Manner for Payment of Supplemental Benefit.

6.1(a) Subject to paragraph 6.1(d) below, if a Participant Separates from Service on or after his Normal Retirement Date, such Participant's Supplemental Retirement Benefit shall be payable commencing the first day of the month following such Participant's Separation from Service. Subject to the forfeiture events of paragraph 5.2, benefits shall be payable to Participant in the form of one hundred eighty (180) monthly installments.

6.1(b) Participant's Supplemental Retirement Benefit, if any, shall be payable commencing on the first day of the month following his Normal Retirement Date if he Separates from Service before his Normal Retirement Date for any reason (other than death, in which case Plan provisions regarding a Supplemental Death Benefit shall apply).

6.1(c) Any Supplemental Death Benefit shall be payable to Participant's designated Beneficiary beginning on the first day of the month immediately following the date of Participant's death and shall be payable for a period of one hundred eighty (180) months.

6.1(d) To the extent that Participant is a Specified Employee on his Separation from Service, any Supplemental Retirement Benefit payable hereunder shall be paid on the later of the date specified in paragraph 6.1(a) or (b), as applicable, or the first day of the month following the six-month anniversary of the Participant's Separation from Service. Any amounts required to be delayed under the preceding sentence to comply with Code section 409A shall be accumulated and paid in a lump sum with interest, at the Prime Rate of Interest in effect on the Participant's Separation from Service date and as reported in the Wall Street Journal.

6.2 Benefit Determination and Payment Procedure. The Administrator shall make all determinations concerning eligibility for benefits under the Plan, the time or terms of payment, to Participant or Participant's Beneficiary, in the event of Participant's death. No benefit shall be payable under the Plan unless the Administrator, in its sole discretion as Plan fiduciary, determines that such benefit is due.

6.3 Payments to Minors and Incompetents. If Participant or his/her designated Beneficiary is a minor or is adjudged to be legally incapable of giving valid receipt and discharge for such benefits, or is deemed so by the Administrator, benefits will be paid to such person as the Administrator may designate for the benefit of Participant or Beneficiary. Such payments shall be considered a direct payment to such Participant or Beneficiary and shall, to the extent made, be deemed a complete discharge of any liability for such payments under the Plan.

6.4 Distribution of Benefit When Distributee Cannot Be Located. The Administrator shall make all reasonable attempts to determine the identity and/or whereabouts of Participant or his/her Beneficiary entitled to benefits under the Plan, including the mailing by certified mail of a notice to the last known address shown on the Bank's records. If the Administrator is unable to locate such a person entitled to benefits hereunder, or if there has been no claim made for such benefits, the Bank shall continue to hold the benefit due such person, subject to any applicable statute of escheats.

6.5 Claims Procedure. Claims for benefits under the Plan must be filed with the Administrator on forms supplied by the Bank. The Administrator shall be responsible for deciding whether such claim is within the scope provided by the Plan (a "Covered Claim") and for providing full and fair review of the decision with respect to such claim. In addition, the Administrator shall provide a full and fair review to the extent required by the Employee Retirement Income Security Act of 1974, as amended, including without limitation Section 503 thereof, (and applicable U.S. Department of Labor Regulations).

Each claimant or other interested person shall file with the Administrator such pertinent information as the Administrator may specify, and in such manner and form as the Administrator may specify and provide, and such person shall not have any rights or be entitled to any benefits or further benefits hereunder, as the case may be, unless such information is filed by the claimant or on behalf of the claimant. Each claimant shall supply at such times and in such manner as may be required, written proof that the benefit is covered under the Plan. If it is determined that a claimant has not incurred a Covered Claim or if the claimant shall fail to furnish such proof as is requested, no benefits or no further benefits hereunder, as the case may be, shall be payable to such claimant.

For all purposes under the Plan, the Administrator's decision with respect to a claim if no review is requested and its decision with respect to a claim if review is requested shall be final, binding and conclusive on all interested parties as to matters relating to the Plan.

ARTICLE VII Funding

7.1 Funding

7.1(a) The undertaking to pay the benefits hereunder shall be an unfunded obligation payable solely from the general assets of the Bank and shall be subject to the claims of the Bank's creditors.

7.1(b) Except as provided in any Trust that may be established as provided in paragraph 7.2, nothing contained in the Plan and no action taken pursuant to the provisions of the Plan shall create, or be construed to create, a trust of any kind or a fiduciary relationship between the Bank and Participant or his designated Beneficiary or any other person or to give Participant or his Beneficiary any right, title or interest in any specific asset or assets of the Bank. To the extent that Participant or a Beneficiary acquires a right to receive payments from the Bank under the Plan, such rights shall be no greater than the right of any unsecured general creditor of the Bank.

7.2 Use of Rabbi Trust Permitted. Subject to the obligations described in paragraph 7.3, the Bank may in its sole discretion elect to establish and fund a "Rabbi" Trust for the purpose of providing benefits under the Plan.

7.3 Obligations upon Change of Control. Upon the occurrence of a Change of Control, the Bank shall be obligated to establish (if one does not already exist) and deposit into a “Rabbi” Trust the actuarially determined present value of Participants vested Supplemental Retirement Benefits determined as of the effective date of the Change of Control. Alternatively, the Bank may obtain a written and binding obligation from the party or parties that will exercise effective control following the Change of control, that the obligations to Participant under this Plan will be assumed and continued by such party.

ARTICLE VIII
Plan Administration

8.1 Appointment of Plan Administrator. The Bank may appoint its Board of Directors, the Human Resources Subcommittee of the Board of Directors, or one or more persons who may or may not also be members of the Board of Directors to serve as the Plan Administrator (the “Administrator”) for the purpose of carrying out the duties specifically imposed on the Administrator by this Plan, the Act and the Code. In the event more than one person is appointed, the persons shall form an administrative committee for the Plan. The person or committee persons serving as Administrator shall serve for indefinite terms at the pleasure of the Bank, and may, by sixty (60) days prior written notice to the Bank, resign or otherwise terminate such appointment.

8.2 Bank as Plan Administrator. In the event that no Administrator is appointed or in office pursuant to paragraph 8.1, the Board of Directors of the Bank shall be the Administrator.

8.3 Compensation and Expenses. Unless otherwise determined and paid by the Board of Directors, the person or committee persons serving as the Administrator shall serve without compensation for service as such. All expenses of the Administrator shall be paid by the Bank.

8.4 Procedure if a Committee. If the Administrator is a committee other than the Human Resources Committee or other standing subcommittee established by the Board of Directors, it shall appoint from its members a chairman and a Secretary. The Secretary shall keep records as may be necessary for the acts and resolutions of such committee and be prepared to furnish reports thereof to the Bank. Except as otherwise provided, all instruments executed on behalf of such committee may be executed by its Chairman or Secretary.

8.5 Action by Majority Vote if a Committee. If the Administrator is a committee, its action in a matter, questions and decisions shall be determined by a majority vote of its members qualified to act thereon. They may meet informally or take any action without the necessity of meeting as a group.

8.6 Appointment of Successors. Upon the death, resignation or removal of a person serving as, or on a committee which serves as the Administrator of the Plan, the Bank, by its Board of Directors may, but need not, appoint a successor.

8.7 Additional Duties and Responsibilities. The Administrator shall have the following duties and responsibilities in addition to those expressly provided elsewhere in the Plan:

8.7(a) The Administrator shall be responsible for the fulfillment of all relevant reporting and disclosure requirements set forth in the Act and the Code, the distribution thereof to Participant and his Beneficiaries and the filing thereof with the appropriate governmental officials and agencies.

8.7(b) The Administrator shall maintain and retain necessary records respecting administration of the Plan and matters upon which disclosure is required under the Act and the Code.

8.7(c) The Administrator shall make any elections for the Plan under the Act or the Code.

8.7(d) The Administrator shall make all determinations regarding eligibility for benefits under the Plan.

8.7(e) The Administrator shall have the right to settle claims against the Plan and to make such equitable adjustments in Participant's or his/her Beneficiary's rights or entitlements under the Plan as it deems appropriate in the event an error or omission is discovered or claimed in the operation or administration of the Plan.

8.8 Power and Discretionary Authority. The Administrator is hereby vested with all the power and authority necessary in order to carry out its duties and responsibilities in connection with the administration of the Plan, including the power to interpret the provisions of the Plan. For such purpose, the Administrator shall have the power to adopt rules and regulations consistent with the terms of the Plan. No benefit shall be payable under the Plan unless the Administrator, in its sole discretion as a Plan fiduciary, determines that such benefit is due.

8.9 Availability of Records. The Bank shall, at the request of the Administrator, make available necessary records or other information they possess which may be required by the Administrator in order to carry out its duties hereunder.

8.10 No Action with Respect to Own Benefit. If Participant also serves as a member of the Administrative Committee, such Participant shall not take any part as the Administrator in any discretionary action in connection with his participation as an individual. Such action shall be taken by the remaining Administrator, if any, or otherwise by the Bank Board of Directors.

8.11 Plan Interpretation and Fiduciary Discretion. The Administrator may construe the Plan, correct defects, supply omissions or reconcile inconsistencies to the extent necessary to effectuate the Plan and such action shall be conclusive.

ARTICLE IX
Amendment and Termination of Plan

9.1 Amendment or Termination of the Plan

9.1(a) The Plan may be terminated at any time by the Board provided, however that such termination is permitted and administered in accordance with Treasury Regulation section 1.409A-3(j)(4)(ix). Upon termination of the Plan and subject to the forfeiture events described in paragraph 5.2, above, the Supplemental Retirement Benefit or, if applicable, the Supplemental Death Benefit of each Participant shall become vested and non-forfeitable.

9.2(b) The Plan may be amended in whole or in part from time to time by the Board effective as of any date specified. No amendment shall operate to decrease Participant's vested Supplemental Retirement Benefit or, if applicable, Supplemental Death Benefit determined as though Participant had terminated employment as of the earlier of the date on which the amendment is approved by the Board or the date on which an instrument of amendment is signed on behalf of the Bank.

9.3(c) The Bank hereby delegates to the Administrator the right to modify, alter, or amend the Plan in whole or in part to make any technical modification, alteration or amendment which in the opinion of counsel for the Bank is required by law and is deemed advisable by the Administrator and to make any other modification, alteration or amendment which does not, in the Administrator's view, substantially increase costs, contributions or benefits and does not materially affect the eligibility, vesting or benefit accrual or allocation provisions of the Plan.

ARTICLE X
Miscellaneous

10.1 Non-assignability. The interest of Participant under the Plan are not subject to claims of the Participants' creditors; and neither Participant, nor his Beneficiary, shall have any right to sell, assign, transfer, or otherwise convey the right to receive any payments hereunder or any interest under the Plan, which payments and interest are expressly declared to be non-assignable and non-transferable.

10.2 Right to Requirement Information and Reliance Thereon. The Bank or the Administrator shall have the right to require Participant, his Beneficiary or other person receiving benefit payments to provide it with such information, in writing, and in such form as to may deem necessary to the administration of the Plan and may rely thereon in carrying out its duties hereunder. Any payment to or on behalf of Participant or his Beneficiary in accordance with the provisions of the Plan in good faith reliance upon any such written information provided by Participant or any other person to whom such payment is made shall be in full satisfaction of all claims by Participant and his

Beneficiary; and any payment to or on behalf of a Beneficiary in accordance with the provision so the Plan in good faith reliance upon any such written information provided by such Beneficiary or any other person to whom such payment is made shall be in full satisfaction of all claims by such Beneficiary.

10.3 Notices and Elections. All notices required to be given in writing and all elections required to be made in writing, under any provision of the Plan, shall be invalid unless made on such forms as may be provided or approved by the Administrator and, in the case of a notice or election by Participant or his Beneficiary, unless executed by Participant or his Beneficiary giving such notice or making such election.

10.4 Delegation of Authority. Whenever the Bank is permitted or required to perform any act, such act may be performed by its Chief Executive Officer or other person duly authorized by its Chief Executive Officer or the Board.

10.5 Service of Process. The Administrator shall be the agent for service of process on the Plan.

10.6 Governing Law. The Plan shall be construed, enforced and administered in accordance with the laws of the Commonwealth of Virginia, and any federal law which preempts the same.

10.7 Binding Effect. The Plan shall be binding upon and inure to the benefits of the Bank, its successors and assigns, and the Participant and his heirs, executors, administrators and legal representatives.

10.8 Severability. If any provision of the Plan should for any reason be declared invalid or unenforceable by a court of competent jurisdiction, the remaining provisions shall nevertheless remain in full force and effect.

10.9 No Effect on Employment Agreement. The Plan shall not be considered or construed to modify, amend or supersede any employment agreement between the Bank and Participant heretofore or hereafter entered into unless so specifically provided.

10.10 Gender and Number. In the construction of the Plan, the masculine shall include the feminine or neuter and the singular shall include the plural and vice-versa in all cases where such meanings would be appropriate.

10.11 Titles and Captions. Titles and captions and headings herein have been inserted for convenience of reference only and are to be ignored in any construction of the provisions hereof.

10.12 Construction. The Plan has been designed to be an unfunded plan maintained primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees as described in the Act, and shall be interpreted and administered as such.

10. 13 Code Section 409A. Any benefit, payment or other right provided by the Plan shall be provided or made in a manner, and at such time, in such form and subject to such election procedures (if any), as complies with the applicable requirements of Code section 409A to avoid a plan failure described in Code section 409A(a)(1), including without limitation, deferring payment until the occurrence of a specified payment event described in Code section 409A(a)(2). Notwithstanding any other provision hereof or document pertaining hereto, the Plan shall be so construed and interpreted to meet the applicable requirements of Code section 409A to avoid a plan failure described in Code section 409A(a)(1).

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Section 7: EX-31.1 (SECTION 302 CEO CERTIFICATION)

Exhibit 31.1

CERTIFICATIONS

I, Ellis L. Gutshall, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Valley Financial Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 13, 2008

By: /s/ Ellis L. Gutshall

President and Chief Executive Officer

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Section 8: EX-31.2 (SECTION 302 CFO CERTIFICATION)

Exhibit 31.2

CERTIFICATIONS

I, Kimberly B. Snyder, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Valley Financial Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the

period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 13, 2008

By: /s/ Kimberly B. Snyder

Executive Vice President and Chief Financial Officer

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Section 9: EX-32.1 (SECTION 906 CEO CERTIFICATION)

Exhibit 32.1

CERTIFICATIONS

The undersigned, as the Chief Executive Officer of Valley Financial Corporation, certifies that the Form 10-Q for the quarter ended September 30, 2008, which accompanies this certification, fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and the information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of Valley Financial Corporation at the dates and for the periods indicated. The foregoing certification is made solely for purposes of Title 18, Chapter 63, Section 1350 of the United States Code and is subject to the knowledge and willfulness qualifications contained in Title 18, Chapter 63, Section 1350(c).

Dated: November 13, 2008

/s/ Ellis L. Gutshall

Chief Executive Officer

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Section 10: EX-32.2 (SECTION 906 CFO CERTIFICATION)

Exhibit 32.2

CERTIFICATIONS

The undersigned, as the Chief Financial Officer of Valley Financial Corporation, certifies that the Form 10-Q for the quarter ended September 30, 2008, which accompanies this certification, fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and the information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of Valley Financial Corporation at the dates and for the periods indicated. The foregoing certification is made solely for purposes of Title 18, Chapter 63, Section 1350 of the United States Code and is subject to the knowledge and willfulness qualifications contained

in Title 18, Chapter 63, Section 1350(c).

Dated: November 13, 2008

/s/ Kimberly B. Snyder
Chief Financial Officer

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