March 6, 2009

Mr. Neil M. Barofsky
Special Inspector General
Office of the Special Inspector General
Troubled Asset Relief Program
1500 Pennsylvania Avenue, N.W.
Suite 1064
Washington, D.C. 20220

Dear Mr. Barofsky,

This letter is in response to your letter of February 6, 2009 requesting information from Valley Financial Corporation ("Company") on its actions involving the TARP Capital Purchase Program and EESA's executive compensation requirements.

Use of TARP Funds

On December 12, 2008, Valley Financial Corporation sold 344,742 shares of Perpetual Preferred Stock to the U.S. Treasury under the TARP Capital Purchase Program resulting in gross sales proceeds of $16,019,000. Initially, these funds were deposited into a money market account maintained at Valley Bank ("Bank"), a wholly-owned subsidiary of the Company. As deposited funds, these monies immediately were employed to support the funding requirements for loans issued and investments purchased by the Bank. As this time, $12,000,000 of these proceeds has been down-streamed to the Bank in the form of equity capital. The remaining $4,019,000 remains in the Company's money market account at the Bank.

During the month of December, 2008, the Bank extended new loans aggregating $22.8 Million representing 143% of the TARP funds within the very first month. Additionally, during January and February of 2009, the Bank extended new loans of $16.8 Million. Therefore, for the three months since receipt of the TARP capital, the Bank has extended new loans totaling $39.6 Million representing 248% of the TARP capital funds, or more accurately stated, the Bank has leveraged the TARP capital funds by a 2.48 to 1 leverage ratio in just the first three months. A detailed lending report for the months of December, January and February is attached as Exhibit 1. For comparison purposes, attached as Exhibit 2 is a detailed lending report for the comparable three months of 2007-2008 which shows total new loan production of $15.6 Million. Attached as Exhibit 3 is a copy of VFC's press release for year-end 2008 that referenced the Company's involvement in the TARP's Capital Purchase Program. Attached as Exhibit 4 is an article published in the Roanoke Times on January 24, 2009, the subject of which was the

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Bank's involvement in the TARP's Capital Purchase Program. Additionally, on December 12, 2008, I made a presentation to The Board Room, a 30-member group of top business leaders located in the Roanoke MSA, describing the program and why the Company chose to participate. Additionally, all officers of the Bank have consistently and routinely presented the Company's case to the Bank's customers in order to make them fully aware of the positive potential of this stimulus program. While the Bank was well capitalized prior to the issuance of the preferred stock to Treasury, absent this additional capital, the Bank would not have pursued such an aggressive lending posture due to the pressure this level of loan growth would have placed on the Bank's capital ratios.

As we go forward, the Bank intends to continue to pursue all activities involving attractive lending opportunities; however, we do not know whether the growth rate of new loan extensions will be as strong as we have experienced during the last three months. While loan demand continues to be brisk, the quality of the credit requests has diminished substantially, which is not unexpected given the current economic situation. [redacted]

It is unfortunate that in recent weeks, public perception of banks' participation in this program has turned negative, and the eventual success of the program may now be in serious jeopardy.

Executive Compensation

Valley Financial Corporation recognizes the importance of annual incentive, profit sharing and long-term equity plans for the recruitment, retention, reward and loyalty of its employees. Additionally, the Company believes in the "pay for performance" incentive philosophy. Therefore, the Company has [redacted] The Plan is directly tied to the Company's strategic goals and objectives set forth in the Company's Strategic Plan. The Plan is designed to reward employees for teamwork and has all employees working towards a common goal. Individual performance metrics are designed to be simple and concise and will lead to the Company's meeting or exceeding its strategic goals and objectives. The performance metrics will most likely have variations from year to year based upon the needs of the Company and annual strategic initiatives.

Based upon the original provisions pursuant to the Emergency Economic Stabilization Act of 2008 and the revised provisions pursuant to the American Recovery and Reinvestment Act of 2009, the Company intends to modify its incentive plans, as follows:

[redacted]

- To specifically state that all compensation programs shall exclude incentives for SEOs to take unnecessary and excessive risks that threaten the value of the Company,
- To specifically state that SEO bonus and incentive compensation are subject to a "clawback" if payments were based on materially inaccurate financial statements or any other materially inaccurate performance criteria, and that these "clawback" provisions shall be applicable to SEOs and the next twenty most highly-compensated employees,
- To specifically state that the Company shall be prohibited from paying or accruing any bonus, retention award or incentive compensation, except for long-term restricted stock, to its most highly-compensated employee, and further shall state that all restricted stock awards granted to its most highly-compensated employee shall not fully vest during the period in which any obligation arising from financial assistance provided under TARP remains outstanding; and further stating that the stock award shall not have a value greater than one-third of this employee's total annual compensation,
- To specifically state that these compensation plans shall not incorporate any activities that would encourage manipulation of reported earnings to enhance the compensation of any employee,

(b) (4) [redacted]

The Company has entered into Employment Agreements with its CEO and CFO that contain provisions regarding change-of-control stipulations, term of employment and non-compete provisions. These agreements shall be amended as follows:

- Golden parachutes, as now defined under the American Recovery and Reinvestment Act of 2009 shall be prohibited during the period in which any obligation arising from financial assistance provided under TARP remains outstanding; and
- The term of employment shall be "at will"; and
- The Company shall waive any non-compete agreements during the period in which any obligation arising from financial assistance provided under TARP remains outstanding.

The Company has entered into Change-of-Control Severance Agreements with its SEOs and the next five most highly-compensated employees. These agreements shall be terminated.

The Human Resources Committee of the Board of the Company is comprised entirely of independent directors and acts as the compensation committee. This committee shall meet at least semi-annually to discuss and evaluate compensation plans. The Company's Chief Risk Officer has been assigned the responsibility to perform and monitor an assessment process of any risk posed to the Company from any compensation plan and to provide reports as necessary. The Human Resources Committee's first meeting to approve these amendments and to perform the risk assessment is scheduled for March 9, 2009.

The Board of Directors of the Company shall establish a company-wide policy regarding excessive or luxury expenditures. The next meeting of the Board is March 26, 2009.

Subject to any final rules and regulations from the Securities and Exchange Commission, the Company shall permit a non-binding shareholder vote to approve the compensation of its executives. The next annual shareholder meeting is scheduled for April 29, 2009.

The Company did pay in 2008 [redacted] (b) (4) (b) (4) (b) (4) The Company shall submit a detailed break-down of incentive awards paid for review by the Treasury.

The Company agrees that no deduction will be claimed for compensation to a SEO in excess of $500,000 during any year in which any obligation arising from financial assistance provided under TARP remains outstanding.

Regarding your question relating to the Company's plans to offset any of these compensation limitations with changes to other, longer-term or deferred forms of compensation, no action has been taken nor is any contemplated at this time.

I hereby certify that all statements, representations and supporting documentation and information contained herein are accurate, subject to the requirements and penalties set forth in Title 18, United States Code, Section 1001.

Very truly yours,

Ellis L. Gutshall

Ellis L. Gutshall
President and
Chief Executive Officer

Exhibit 1

Sum of Original Amount		Years	Open Date		
		2008	2009		Grand Total
Product	Name	Dec	Jan	Feb	
Acquisition/Development – Commercial Owner Occupied		$ -			$ -
Acquisition/Development – Non-Owner Occupied		$ -	$ -	$ 2,080,000	$ 2,080,000
Comm R/E - Income Prod		$ 17,458,000	$ 10,006,500	$ 1,048,000	$ 28,512,500
Comm R/E - Owner Occupied		$ 2,687,550	$ 1,047,415	$ 640,653	$ 4,375,618
Commercial LOC		$ -	$ -	$ -	$ -
Commercial Single Pay		$ 291,500	$ 24,650		$ 316,150
Commercial Term		$ 615,994	$ 255,686	$ 345,660	$ 1,217,340
Consumer Loan		$ 312,244	$ 117,225	$ 71,035	$ 500,504
Farmland		$ 300,000			$ 300,000
Home Equity Lines		$ -	$ -	$ -	$ -
Letter of Credit			$ -	$ -	$ -
Residential R/E		$ 1,153,479	$ 68,000	$ 945,568	$ 2,167,047
Home Equity Loans				$ 106,000	$ 106,000
Grand Total		$ 22,818,767	$ 11,519,476	$ 5,236,916	$ 39,575,159

Exhibit 2

Sum of Original Amount		Years	Open Date		
		2007	2008		Grand Total
Product	Name	Dec	Jan	Feb	
Acquisition/Development – Commercial Owner Occupied		$ -	$ -		$ -
Acquisition/Development – Non-Owner Occupied		$ -	$ -	$ -	$ -
Business Manager			$ -		$ -
Comm R/E - Income Prod		$ 3,084,000	$ 3,508,937	$ 1,340,086	$ 7,933,023
Comm R/E - Owner Occupied		$ 395,000	$ -	$ 453,683	$ 848,683
Commercial LOC		$ -	$ -	$ -	$ -
Commercial Single Pay		$ 239,951	$ 1,200,000	$ 132,170	$ 1,572,121
Commercial Term		$ 729,706	$ 419,463	$ 190,000	$ 1,339,169
Consumer Loan		$ 184,351	$ 206,767	$ 359,367	$ 750,485
Farmland			$ 205,278		$ 205,278
Home Equity Lines		$ -	$ -	$ -	$ -
Residential R/E		$ 2,116,725	$ 383,100	$ 477,500	$ 2,977,325
Grand Total		$ 6,749,733	$ 5,923,545	$ 2,952,806	$ 15,626,084

Valley Financial Corporation ▲

FOR RELEASE 4:00 p.m. January 29, 2009

VALLEY FINANCIAL CORPORATION
36 Church Avenue, S.W.
Roanoke, Virginia 24011

For Further Information Contact:

Ellis L. Gutshall, President and Chief Executive Officer
Kimberly B. Snyder, Executive Vice President and Chief Financial Officer
(540) 342-2265

VALLEY FINANCIAL CORPORATION ANNOUNCES 2008 EARNINGS OF $1.7 MILLION AND FOURTH QUARTER LOAN GROWTH OF $39 MILLION

ROANOKE, VIRGINIA. January 29, 2008 -- Roanoke-based Valley Financial Corporation (NASDAQ Capital Market-VYFC) announced today its consolidated financial results for the year ended December 31, 2008.

For the year ended December 31, 2008, Valley Financial reported net income of $1,773,000 compared with $2,928,000 for the same twelve months of 2007, a 39% decrease. Valley Financial's earnings for the year produced an annualized return on average total assets of 0.28% and an annualized return on average shareholders' equity of 4.09%, compared to prior year ratios of 0.50% and 8.03%, respectively. Diluted earnings per share were down 46% from $0.68 in 2007 to $0.37 in 2008. Diluted earnings per share are calculated using net income available to common shareholders of $1,729,000 for the year ended December 31, 2008. The Company's earnings for 2008 were adversely affected by specific and general reserves taken in response to the unprecedented turbulence in the financial markets and economy that continue to impact asset quality. The Company's loan loss provision was $3,177,000 for the year ended December 31, 2008, as compared to $1,250,000 for the same period last year.

For the three months ended December 31, 2008, Valley Financial reported net loss of $380,000 compared to net income of $925,000 for the same three months of 2007. Return on average total assets was (0.23%) for the quarter and return on average shareholders equity was (3.21%) compared with 0.62% and 9.06% respectively, for the same period in 2007. The provision for loan losses was $2,063,000 for the quarter ended December 31, 2008, as compared to ($74,000) for the same period of 2007.

Ellis L. Gutshall, President and CEO, stated, "As of December 31, 2008, total non-performing assets amounted to $10,012,000 or 1.48% of total assets, compared to $7,474,000, or 1.24% of total assets as of December 31, 2007, representing a $2,538,000 or 34% increase year over year. These non-performing assets, many of which have not yet resulted in actual losses, are deemed to be impaired. Included in our provision for the fourth quarter of 2008 are specific reserves of $1,571,000 and $492,000 in general reserves and we feel these reserves are prudent given the uncertainty surrounding the current state of the economy. The Company's allowance for loan and lease losses stood at 1.35% of total loans at December 31, 2008 as compared to 1.00% as of December 31, 2007. The Company actually recorded net recoveries for the quarter ended December 31, 2008 of $4,600. We anticipate provisioning levels to continue to be elevated for 2009 and the levels will depend on the depth and length of the current recession."

At December 31, 2008, Valley Financial's total assets were $674,575,000, total deposits were $466,335,000, total loans stood at $553,045,000 and total shareholders' equity was $58,601,000. Compared with December 31, 2007, the Company experienced increases of $73,608,000 or 12% in total assets, $33,882,000 or 8% in total deposits and $65,881,000 or 14% in total loans over the twelve-month period.

Ellis L. Gutshall, President and CEO, stated "While our competitors may be pulling back on issuing credit, we at Valley Bank continue to experience strong loan demand and strong core deposit growth from customers who prefer dealing with a local, established community bank. The Company issued $16,019,000 in preferred stock to the U. S. Treasury Department in mid-December. As a result, during the fourth quarter our loan portfolio grew at a rate equal to over four times the growth rate for the first nine months of the year. We recorded $38,728,000 in net loan growth for the quarter as compared to $27,153,000 for the first three quarters of 2008 combined."

The Company's net interest margin was 2.90% for the year ended December 31, 2008, up 6 basis points compared to the 2.84% reported for the same period last year. The net interest margin for the fourth quarter was 2.93% up 12 basis points as compared to 2.81% in the fourth quarter of last year. Gutshall stated, "We continue to be 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. 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."

Gutshall further stated, "The fourth quarter was the most challenging in our company's history and we are obviously disappointed to report a net loss for the quarter. The severe economic downturn is taking its toll on many of our business customers, especially those in the automobile and real estate industries, and there is no quick fix for the credit quality issues that are plaguing the financial services industry. As a result, we feel it is only prudent to take a more aggressive approach in our overall provisioning for loan and lease losses as we head into 2009. We remain confident in our ability to navigate through the effects of the current economic and financial environment."

Valley Financial's already strong capital base was enhanced during the fourth quarter of 2008 by $16,019,000 in proceeds from the US Treasury Capital Purchase Program. The Company's total risk-based capital ratio was 14.4% at December 31, 2008 compared to 12.0% at September 30, 2008. This ratio is well in excess of the 10% regulatory minimum to be categorized as well-capitalized. Gutshall stated "We have already begun the implementation of our strategic initiatives to deploy this new capital in the form of new lending to businesses and individuals situated in the Roanoke Valley. In addition to our lending initiatives, we plan to continue to pursue opportunities to support the mortgage industry through our investment in high-quality mortgaged-backed securities and to support municipalities through our investment in their general obligation debt instruments. We are extremely proud that the U.S. Treasury chose to make an investment in Valley Financial Corporation and are pleased to be among the group of banks to complete the transaction. The capital purchase program was established by the U.S. Treasury to attract participation by healthy financial institutions to help stabilize the financial system and increase lending for the benefit of the U.S. economy."

About Valley Financial Corporation

Valley Financial Corporation is the holding company for Valley Bank, which opened in 1995 and engages in a general commercial and retail banking business in the Roanoke Valley, emphasizing the needs of small businesses, professional concerns and individuals. Valley Bank currently operates from eight full-service offices at 36 Church Avenue, 110 McClanahan Street, 1518 Hershberger Road, 3850 Keagy Road, and 1327 Grandin Road in Roanoke City, 4467 Starkey Road in Roanoke County, 8 East Main Street in the City of Salem, and 1003 Hardy Road in the Town of Vinton. Additionally, the Bank operates its wealth management subsidiary, Valley Wealth Management Services, Inc. at 36 Church Avenue in Roanoke City. The Bank's Internet site at www.myvalleybank.com is available for online banking and extensive investor information.

The Common Stock of Valley Financial Corporation is traded on the NASDAQ Capital Market under the symbol VYFC.

Non-GAAP Financial Measures

This report refers to the overhead efficiency ratio, which is computed by dividing non-interest expense by the sum of net interest income on a tax equivalent basis and non-interest income excluding gains or losses on securities, fixed assets and foreclosed assets. This is a non-GAAP financial measure that we believe provides investors with important information regarding our operational efficiency. Comparison of our efficiency ratio with those of other companies may not be possible, because other companies may calculate the efficiency ratio differently. Such information is not in accordance with generally accepted accounting principles in the United States (GAAP) and should not be construed as such. Management believes such financial information is meaningful to the reader in understanding operating performance, but cautions that such information not be viewed as a substitute for GAAP. Valley Financial Corporation, in referring to its net income, is referring to income under GAAP.

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.

	Three Months Ended 12/31/08	Twelve months Ended 12/31/08
Net interest income, non tax-equivalent	$ 4,560	$ 17,199
Less: tax-exempt interest income	(85)	(378)
Add: tax-equivalent of tax-exempt interest income	129	573
Net interest income, tax-equivalent	$ 4,604	$ 17,394

Forward Looking Statements

Information in this press release contains "forward-looking statements." These statements involve risks and uncertainties that could cause actual results to differ materially, including without limitation, the effects of future economic conditions, governmental fiscal and monetary policies, legislative and regulatory changes, the risks of changes in interest rates and the effects of competition. Additional factors that could cause actual results to differ materially are discussed in Valley Financial Corporation's recent filings with the Securities and Exchange Commission, included but not limited to its Annual Report on Form 10-K and its other periodic reports.

VALLEY FINANCIAL CORPORATION
CONSOLIDATED FINANCIAL HIGHLIGHTS
(dollars in thousands, except per share amounts)

	(Unaudited) December 31 2008	December 31 2007
Total assets	$ 674,575	$ 600,967
Total loans	553,045	487,164
Investments	92,851	81,085
Deposits	466,335	432,453
Borrowed funds	143,515	121,078
Shareholders' equity	58,601	40,716
Non-performing assets to total assets	1.48%	1.24%
Loans past due more than 90 days to total loans	0.01%	0.00%
Allowance for loan losses to total loans	1.35%	1.00%
Book value per common share, exclusive of accumulated other comprehensive income (loss)	$9.00	$8.86

VALLEY FINANCIAL CORPORATION
CONSOLIDATED FINANCIAL HIGHLIGHTS
(Dollars in thousands, except per share amounts)

	For the Three Months Ended December 31		For the Year Ended December 31	
	2008	2007	2008	2007
Interest income	$8,877	$9,775	$36,117	$38,993
Interest expense	4,317	5,820	18,918	23,393
Net interest income	4,560	3,955	17,199	15,600
Provision for loan losses	2,063	(74)	3,177	1,250
Net interest income after provision for loan losses	2,497	4,029	14,022	14,350
Noninterest income	545	557	2,411	2,326
Noninterest expense	3,623	2,923	14,033	12,699
Net income before taxes	(581)	1,663	2,400	3,977
Provision for income taxes	(201)	738	627	1,049
Net income/(loss)	$(380)	$925	$1,773	$2,928
Preferred dividend	44	-	44	-
Net income/(loss) available to common shareholders	($424)	$925	$1,729	$2,928
Basic net income/(loss) per share	($0.09)	$0.20	$0.37	$0.69
Diluted net income/(loss) per share	($0.09)	$0.20	$0.37	$0.68
Return on average total assets	(0.23%)	0.62%	0.28%	0.50%
Return on average total equity	(3.21%)	9.06%	4.09%	8.03%
Yield on earning assets (TEY)	5.67%	6.89%	6.05%	7.03%
Cost of funds	2.85%	4.23%	3.26%	4.31%
Net interest margin (TEY)	2.93%	2.81%	2.90%	2.84%
Overhead efficiency ratio	69.47%	72.41%	69.86%	68.88%
Net charge-offs/average loans	0.00%	0.08%	0.12%	0.42%

THE ROANOKE TIMES
roanoke.com

VALLEY BANK FINDS ITSELF IN LENDING JAM

Date: January 24, 2009 **Section:** BUSINESS **Page:** C8

By Jeff Sturgeon jeff.sturgeon@roanoke.com 381-1661

Valley Bank's parent company, Valley Financial Corp. of Roanoke, received $16 million last month to increase lending activity in the Roanoke Valley under the federally funded economic rescue program.

On Thursday, its chief executive officer said he expects the bank will be positioned to loan substantial additional money to business and individual clients this year. Sound promising?
But CEO Ellis Gutshall also said he is not certain there will be takers for all the loans he expects to be able to make.
The bank expects to have the money to lend an additional $160 million over several years, because a dollar in new capital supports many dollars in new loans.
"The difficulty," Gutshall said Thursday, "is finding enough good opportunities to put that money to use."
Gutshall said the economy appears "stuck" until housing activity resumes. It could last 12 to 18 months, he said.
The U.S. government is deploying billions of tax dollars to strengthen the U.S. financial system and restart economic growth. Approved Oct. 3, the massive spending plan is called the Troubled Assets Relief Program.
One component, the Capital Purchase Program, differs from the cash bailout strategy, which focuses on struggling firms. The program funds investments in healthy banks to increase lending with the goal of helping restore business activity to pre-recession levels.
Valley Financial, with eight branches and a focus on the Roanoke Valley, qualified, as did StellarOne, one of the largest Virginia-based banks and the successor to First National Bank of Christiansburg. It received $30 million. All major U.S. banks were also funded.
But with nearly $300 billion now deployed, the use of the bailout money has been a source of disagreement.
On one front, critics have faulted the economic rescue strategy for producing too few results during the nearly four months

since it began. Among other charges, they said that if banks are not lending more, the federal infusion is not working adequately.

Neel Kashkari, who administers TARP, said in Washington earlier this month that flagging confidence in the economy is the problem that's making consumers and businesses cautious about borrowing and banks cautious about extending credit. As confidence is restored, he predicted banks and borrowers will sign new loans.

The American Bankers Association also supports continuing the course. It said banks are critical to the recovery and have been expanding credit in spite of the recession, while nonbank credit has virtually dried up. The banking association said the Capital Purchase Program injects essential capital into banks at a time when traditional capital-raising is not possible.

Without more capital to anchor deposits that are the source of loans, banks can't lend more.

But there is little patience for waiting for results.

Federal officials are calling on banks that received the most Capital Purchase Program money to report how they have spent the funds. In addition, bank shareholders are looking out for their interests.

Because the funds carry a cost in the form of dividend payments to the U.S. Treasury, shareholders want to see increased earnings at least enough to cover that expense and, ideally, more, Gutshall said.

Valley Bank was profitable through the third quarter of last year, earning nearly $2.2 million, up from $2 million during the same period of 2007. Deposits and lending increased. Fourth-quarter and full-year earnings results are due out Friday.

Gutshall said **Valley Bank** is wasting no time and is already marketing the availability of its plentiful credit. And the bank has achieved some results.

"We increased lending activity threefold toward the end of the year compared to what we were doing," he said. "Whether we can sustain that is anybody's guess."

If the economy contracts further, "2009 could be worse than 2008. It really could," he said.

What would the beginning of a turnaround look like?

"Business owners must re-kindle their confidence in their business models and revenue-generating prospects in order to take on more debt, because to take on more debt, they will have to be ready to invest more of their personal financial resources," he said.

"Tomorrow's growth will not be financeable solely through bank loans due to the higher risk profile that currently exists in

this environment."
Gutshall said the government could entice business owners to make such investments even before consumers resume buying with "some form of tax incentive to provide some return for the investment while waiting for profitability to reappear."

Caption: photo - Ellis Gutshall - CEO says bank is marketing its available credit.
