

THIRD QUARTER 2007

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Richard A. Eason
Chief Executive Officer



Ronald J. Allen
Chairman of the Board

October 26, 2007

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

(dollars in thousands)

The following commentary reviews the financial condition and results of operations of Cape Fear Farm Credit ACA, (Association) for the period ended September 30, 2007. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2006 Annual Report of the Association. The accompanying consolidated financial statements were prepared under the oversight of the Audit Committee of the Board of Directors.

LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans. The Association's loan portfolio is diversified over a range of agricultural commodities in our region, including tobacco, swine, poultry, and row-crop operations. Farm size varies and many of the borrowers in the region have diversified farming operations. This factor, along with the numerous opportunities for non-farm income in the area, lessens the level of dependency on any single given commodity. Concentration risk is further mitigated by a substantial portfolio of participation loans purchased or originated and sold.

The gross loan volume of the Association as of September 30, 2007 was \$707,789, an increase of \$77,382 as compared to \$630,407 at December 31, 2006. Net loans outstanding at September 30, 2007, were \$703,626 as compared to \$626,800 at December 31, 2006. Net loans accounted for 91.54 percent of total assets at September 30, 2007, as compared to 90.90 percent of total assets at December 31, 2006.

The increase in gross and net loan volume during the reporting period is attributed to a general increase in lending activity including seasonal lending sufficient to reflect overall growth despite significant paydowns from assignments on contract grower loans. The short-term portfolio, which is heavily influenced by operating-type loans, normally reaches a peak in August and rapidly declines in the fall months as farm commodities are marketed and proceeds are applied to the operating loans.

There is an inherent risk in the extension of any type of credit. Portfolio credit quality continues to be maintained at an acceptable level, however, and credit administration remains satisfactory. Nonaccrual loans increased from \$921 at December 31, 2006 to \$2,351 at September 30, 2007. This increase results primarily from the transfer of three loans into nonaccrual status during the first three quarters of 2007.

Association management maintains an allowance for loan losses in an amount considered sufficient to absorb possible losses in the loan portfolio based on current and expected future conditions. The allowance for loan losses at September 30, 2007 was \$4,163, an increase of \$556 from the December 31, 2006 amount of \$3,607. This increase is primarily due to growth in the portfolio in the past three quarters and was considered by management to be adequate to cover possible losses.

RESULTS OF OPERATIONS

For the three months ended September 30, 2007

Net income for the three months ended September 30, 2007 totaled \$4,841 as compared to \$4,419 for the same period in 2006. The increase of \$422 or 9.55 percent is attributed to an increase in net interest income resulting from growth in loan volume and also noninterest income in the areas of loan fees and equity earnings in other Farm Credit institutions.

Net interest income for the three months ended September 30, 2007 increased \$623 or 12.13 percent compared to September 30, 2006. Interest income on loans increased by \$2,460 and interest income from other sources increased by \$21, while interest expense increased \$1,858 compared to the same period last year. These increases are both due to a growth in loan volume and other interest bearing assets. Nonaccrual income was \$6 for the three months ended September 30, 2007, as compared to \$106 for the same period in 2006.

Noninterest income for the three months ended September 30, 2007 totaled \$2,146 as compared to \$1,853 for the same period of 2006, an increase of \$293. The increase resulted from an increase of \$197 in patronage earnings from AgFirst Farm Credit Bank (Bank), an increase of \$118 in loan fee income, and an increase of \$20 in other noninterest income. These increases were offset by a decline of \$41 in fees for financially related services and a decline of \$1 in gains on other property owned.

Noninterest expense for the three months ended September 30, 2007 increased \$350 compared to the same period of 2006. This increase resulted primarily from increases of \$246 in salaries and benefits, \$37 in the Insurance Fund premium, and \$76 in other operating expenses. These increases were offset by a decline of \$9 in occupancy and equipment expense.

For the nine months ended September 30, 2007

Net income for the nine months ended September 30, 2007 totaled \$14,455 as compared to \$12,319 for the same period in 2006. The increase of \$2,136 or 17.34 percent is attributed primarily to an increase in net interest income resulting from growth in loan volume and an increase in noninterest income.

At September 30, 2007, net interest income increased \$2,222 or 15.46 percent compared to September 30, 2006. Interest income on loans increased by \$8,398 and interest income from other sources increased by \$112, while interest expense increased \$6,288 compared to the same period last year. These increases are both due to growth in loan volume and other interest bearing assets. Nonaccrual income was \$88 for the nine months ended September 30, 2007, as compared to \$197 for the same period in 2006.

Noninterest income for the nine months ended September 30, 2007 totaled \$6,702 as compared to \$5,546 for the same period of 2006, an increase of \$1,156. The increase resulted from an increase of \$779 in patronage earnings from AgFirst Farm Credit Bank (Bank), an increase of \$363 in loan fee income, and an increase of \$59 in other noninterest income. These increases were offset by a decline of \$43 in fees for financially related services and a decline of \$2 in gains on other property owned.

Noninterest expense for the nine months ended September 30, 2007 increased \$865 compared to the same period of 2006. This increase resulted primarily from increases of \$541 in salaries and benefits, \$116 in the Insurance Fund premium, and \$214 in other operating expenses. These increases were offset by a decrease of \$6 in occupancy and equipment expense.

FUNDING SOURCES

The principal source of funds for the Association is the borrowing relationship established with the Bank through a General Financing Agreement. The General Financing Agreement utilizes the Association's credit and fiscal performance as criteria for establishing a line of credit on which the Association may draw funds. The funds are advanced by the Bank to the Association in the form of notes payable. The notes payable are segmented into variable rate and fixed rate sections. The variable rate note is utilized by the Association to fund variable rate loan advances and operating funds requirements. The fixed rate note is used

specifically to fund fixed rate loan advances made by the Association. The total notes payable to the Bank at September 30, 2007, were \$648,756 as compared to \$563,329 at December 31, 2006.

CAPITAL RESOURCES

Total members' equity at September 30, 2007 increased to \$107,793 from the December 31, 2006 total of \$99,205. The increase results primarily from earnings retained from the prior year in excess of the current year rollout of allocated surplus.

Farm Credit Administration (FCA) regulations require all Farm Credit institutions to maintain minimum permanent capital, total surplus and core surplus ratios. These ratios are calculated by dividing the Association's permanent capital, total surplus and core surplus as defined in FCA regulations, by a risk-adjusted asset base. As of September 30, 2007, the Association's total surplus ratio and core surplus ratio were 12.87 percent and 11.49 percent, respectively, and the permanent capital ratio was 13.22 percent. All three ratios were well above the minimum regulatory ratios of 7.00 percent for permanent capital and total surplus ratios and 3.50 percent for the core surplus ratio.

NOTE: Shareholder investment in the Association could be affected by the financial condition and results of operations of AgFirst Farm Credit Bank. Copies of AgFirst's annual and quarterly reports are available upon request free of charge by calling 1-800-845-1745, ext. 316, or writing Wanda Martin, AgFirst Farm Credit Bank, P.O. Box 1499, Columbia, SC 29202. Information concerning AgFirst Farm Credit Bank can also be obtained at their website, www.agfirst.com. Copies of the Association's annual and quarterly reports are also available upon request free of charge by calling 1-800-368-5819 ext. 3243, writing Matthew J. Currin, Chief Financial Officer, Cape Fear Farm Credit, P. O. Box 2405, Fayetteville, NC 28302, or accessing the website, www.capefearfarmcredit.com. The Association prepares a quarterly report within 45 days after the end of each fiscal quarter, except that no report need be prepared for the fiscal quarter that coincides with the end of the fiscal year of the institution.

Cape Fear Farm Credit, ACA

Consolidated Balance Sheets

<i>(dollars in thousands)</i>	September 30, 2007 <i>(unaudited)</i>	December 31, 2006 <i>(audited)</i>
Assets		
Cash	\$ 1,109	\$ 1,529
Loans	707,789	630,407
Less: allowance for loan losses	4,163	3,607
Net loans	703,626	626,800
Other investments, held to maturity	27,405	27,484
Accrued interest receivable	15,000	10,704
Investment in other Farm Credit institutions	8,370	8,370
Premises and equipment, net	3,529	3,261
Prepaid retirement expense	4,669	5,078
Due from AgFirst Farm Credit Bank	4,211	5,701
Other assets	695	645
Total assets	<u>\$ 768,614</u>	<u>\$ 689,572</u>
Liabilities		
Notes payable to AgFirst Farm Credit Bank	\$ 648,756	\$ 563,329
Accrued interest payable	3,175	2,736
Patronage refund payable	110	9,023
Postretirement benefits other than pensions	4,131	3,995
Minimum pension liability	379	372
Other liabilities	4,270	10,912
Total liabilities	<u>660,821</u>	<u>590,367</u>
Commitments and contingencies		
Members' Equity		
Protected borrower equity	132	204
Capital stock and participation certificates	2,521	2,333
Retained earnings		
Allocated	9,890	15,881
Unallocated	95,608	81,145
Accumulated other comprehensive income (loss)	(358)	(358)
Total members' equity	<u>107,793</u>	<u>99,205</u>
Total liabilities and members' equity	<u>\$ 768,614</u>	<u>\$ 689,572</u>

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

Cape Fear Farm Credit, ACA

Consolidated Statements of Income

(unaudited)

<i>(dollars in thousands)</i>	For the three months ended September 30,		For the nine months ended September 30,	
	2007	2006	2007	2006
Interest Income				
Loans	\$ 14,982	\$ 12,522	\$ 42,255	\$ 33,857
Other	418	397	1,207	1,095
Total interest income	15,400	12,919	43,462	34,952
Interest Expense				
Notes payable to AgFirst Farm Credit Bank	9,643	7,785	26,868	20,580
Net interest income	5,757	5,134	16,594	14,372
Provision for (reversal of allowance for) loan losses	285	79	537	79
Net interest income after provision for (reversal of allowance for) loan losses	5,472	5,055	16,057	14,293
Noninterest Income				
Loan fees	638	520	2,217	1,854
Fees for financially related services	53	94	148	191
Equity in earnings of other Farm Credit institutions	1,449	1,252	4,228	3,449
Gains (losses) on other property owned, net	1	2	4	6
Other noninterest income	5	(15)	105	46
Total noninterest income	2,146	1,853	6,702	5,546
Noninterest Expense				
Salaries and employee benefits	1,794	1,548	5,469	4,928
Occupancy and equipment	247	256	603	609
Insurance Fund premium	256	219	726	610
Other operating expenses	480	404	1,506	1,292
Total noninterest expense	2,777	2,427	8,304	7,439
Income before income taxes	4,841	4,481	14,455	12,400
Provision (benefit) for income taxes	—	62	—	81
Net income	\$ 4,841	\$ 4,419	\$ 14,455	\$ 12,319

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

Cape Fear Farm Credit, ACA
Consolidated Statements of Changes in
Members' Equity

(unaudited)

(dollars in thousands)

	Protected Borrower Capital	Capital Stock and Participation Certificates	Retained Earnings		Accumulated Other Comprehensive Income	Total Members' Equity
			Allocated	Unallocated		
Balance at December 31, 2005	\$ 269	\$ 2,154	\$ 22,035	\$ 72,268	\$ (404)	\$ 96,322
Net income				12,319		12,319
Protected borrower equity retired	(60)					(60)
Capital stock/participation certificates issued		268				268
Capital stock/participation certificates retired		(140)				(140)
Retained earnings retired			(6,155)			(6,155)
Distribution adjustment			3	139		142
Balance at September 30, 2006	\$ 209	\$ 2,282	\$ 15,883	\$ 84,726	\$ (404)	\$ 102,696
Balance at December 31, 2006	\$ 204	\$ 2,333	\$ 15,881	\$ 81,145	\$ (358)	\$ 99,205
Net income				14,455		14,455
Protected borrower equity retired	(72)					(72)
Capital stock/participation certificates issued		314				314
Capital stock/participation certificates retired		(126)				(126)
Retained earnings retired			(5,991)			(5,991)
Distribution adjustment			—	8		8
Balance at September 30, 2007	\$ 132	\$ 2,521	\$ 9,890	\$ 95,608	\$ (358)	\$ 107,793

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

Cape Fear Farm Credit, ACA

Notes to the Consolidated Financial Statements

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

NOTE 1 – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

A description of the organization and operations of Cape Fear Farm Credit, ACA (the Association), the significant accounting policies followed, and the financial condition and results of operations as of and for the year ended December 31, 2006, are contained in the 2006 Annual Report to Shareholders. These unaudited third quarter 2007 consolidated financial statements should be read in conjunction with the 2006 Annual Report to Shareholders.

On September 29, 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 158 – Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans. The Standard requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in that funded status in the year in which the changes occur through comprehensive income. The Standard is effective for employers with publicly traded securities for the fiscal year ending after December 15, 2006 and for employers without publicly traded securities for the fiscal year ending after June 15, 2007. The Association will be required to implement the Standard for the year ended December 31, 2007. In addition, this Standard requires that the funded status of a plan be measured as of the date of the year-end financial statements. Currently, the Association uses a measurement date of September 30th. The requirement to measure the funded status as of the fiscal year-end is effective for fiscal years ending after December 15, 2008. The Association is currently evaluating the impact of implementing this Standard. It is anticipated that the impact from the implementation of this Standard will have no impact on the consolidated income statement and, based on the current funded status of the defined benefit plans, it is not expected to have a material or significant impact on the consolidated balance sheet.

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

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

The Association maintains an allowance for loan losses in accordance with generally accepted accounting principles.

The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of September 30, 2007, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

NOTE 2 – ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses follows:

	For the nine months ended September 30,	
	2007	2006
Balance at beginning of period	\$ 3,607	\$ 3,434
Provision for (reversal of) loan losses	537	79
Recoveries, net of loans charged off	19	–
Balance at end of period	<u>\$ 4,163</u>	<u>\$ 3,513</u>

NOTE 3 – EMPLOYEE BENEFIT PLANS

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

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

	For the nine months ended September 30,	
	2007	2006
Pension	\$ 437	\$ 560
Thrift/deferred compensation	137	104
Other postretirement benefits	290	300
Total	<u>\$ 864</u>	<u>\$ 964</u>

As of September 30, 2007, no contributions have been made to the pension plan for 2007. The Association does not anticipate making additional contributions for the remainder of 2007.

The Association also sponsors a supplemental retirement plan for certain key employees. The expenses of this plan are included in the pension costs above. The Association contributed \$21 to this plan during the first nine months of 2007. The Association anticipates making additional contributions of \$7 to the supplemental retirement plan during the remainder of 2007.