

FIRST QUARTER 2006

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Chief Executive Officer



Ronald J. Allen
Chairman of the Board

April 28, 2006

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 March 31, 2006. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2005 Annual Report of the Association.

LOAN PORTFOLIO

The Association provides funds to farmers, rural homeowners and farm-related businesses for financing of short and intermediate-term loans and long-term real estate mortgage loans. The Association's loan portfolio is diversified over a range of agricultural commodities in our region, including 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 March 31, 2006, was \$541,255, an increase of \$22,057 as compared to \$519,198 at December 31, 2005. Net loans outstanding at March 31, 2006, were \$537,821 as compared to \$515,764 at December 31, 2005. Net loans accounted for 91.53 percent of total assets at March 31, 2006, as compared to 91.65 percent of total assets at December 31, 2005.

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 decreased from \$1,997 at

December 31, 2005, to \$1,577 at March 31, 2006. This decrease results primarily from the liquidation of two loans during the first quarter of 2006.

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 March 31, 2006, was \$3,434, which was unchanged from December 31, 2005, and was considered by management to be adequate to cover possible losses.

RESULTS OF OPERATIONS

For the three months ended March 31, 2006

Net income for the three months ended March 31, 2006, totaled \$3,882 as compared to \$3,488 for the same period in 2005. The increase of \$394 or 11.31 percent is attributed primarily to an increase in net interest income resulting from growth in loan volume and an increase in market interest rates.

Net interest income for the three months ended March 31, 2006, increased \$489 or 12.25 percent compared to March 31, 2005. Interest income on loans increased by \$2,191 and interest income from other sources increased by \$326, while interest expense increased \$2,027 compared to the same period last year. These increases are both due to increases in market interest rates and growth in loan volume and other interest bearing assets. Nonaccrual income was \$78 for the three months ended March 31, 2006, as compared to \$220 for the same period in 2005.

Noninterest income for the three months ended March 31, 2006, totaled \$1,950 as compared to \$1,683 for the same period of 2005, an increase of \$267. The increase resulted from an increase of \$142 in patronage earnings from AgFirst Farm Credit Bank (Bank), an increase of \$22 in other noninterest income, and an increase in loan fee income of \$142, offset in part by a decrease of \$39 in fees for financially related services.

Noninterest expense for the three months ended March 31, 2006, increased \$343 compared to the same period of 2005. This increase resulted from increases of \$144 in Insurance Fund premium, \$52 in other operating expense, \$122 in salaries and employee benefits, and occupancy and equipment expense of \$25.

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 March 31, 2006, were \$476,652 as compared to \$447,981 at December 31, 2005.

CAPITAL RESOURCES

Total members' equity at March 31, 2006, decreased to \$94,223 from the December 31, 2005, total of \$96,322. The decrease results primarily from current year rollout of allocated surplus being in excess of the amount of net earnings for the association thus far.

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 March 31, 2006, the Association's total surplus ratio and core surplus ratio were 15.83 percent and 12.72 percent, respectively, and the permanent capital ratio was 16.23 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. 378, or writing Jay Wise, 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 910-323-9188, writing Henry McDuffie, 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>	March 31, 2006 <i>(unaudited)</i>	December 31, 2005 <i>(audited)</i>
Assets		
Cash	\$ 3,619	\$ 2,610
Loans	541,255	519,198
Less: allowance for loan losses	3,434	3,434
Net loans	537,821	515,764
Other investments	21,994	15,367
Accrued interest receivable	7,800	7,802
Investment in other Farm Credit institutions	5,674	5,674
Premises and equipment, net	3,423	3,403
Prepaid retirement expense	5,608	5,787
Due from AgFirst Farm Credit Bank	—	5,579
Other assets	1,674	779
Total assets	<u>\$ 587,613</u>	<u>\$ 562,765</u>
Liabilities		
Notes payable to AgFirst Farm Credit Bank	\$ 476,652	\$ 447,981
Accrued interest payable	2,110	1,868
Patronage refund payable	227	7,016
Postretirement benefits other than pensions	3,830	3,778
Minimum pension liability	411	409
Other liabilities	10,160	5,391
Total liabilities	<u>493,390</u>	<u>466,443</u>
Commitments and contingencies		
Members' Equity		
Protected borrower equity	221	269
Capital stock and participation certificates	2,188	2,154
Retained earnings		
Allocated	15,917	22,035
Unallocated	76,301	72,268
Accumulated other comprehensive income (loss)	(404)	(404)
Total members' equity	<u>94,223</u>	<u>96,322</u>
Total liabilities and members' equity	<u>\$ 587,613</u>	<u>\$ 562,765</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 March 31,	
	2006	2005
Interest Income		
Loans	\$ 10,106	\$ 7,915
Other	326	—
	10,432	7,915
Interest Expense		
Notes payable to AgFirst Farm Credit Bank	5,947	3,919
	4,485	3,996
Provision for (reversal of allowance for) loan losses	—	—
	4,485	3,996
Noninterest Income		
Loan fees	747	605
Fees for financially related services	68	107
Equity in earnings of other Farm Credit institutions	1,069	927
Gains (losses) on other property owned, net	2	2
Other noninterest income	64	42
	1,950	1,683
Noninterest Expense		
Salaries and employee benefits	1,697	1,575
Occupancy and equipment	188	163
Insurance Fund premium	188	44
Other operating expenses	461	409
	2,534	2,191
Income before income taxes	3,901	3,488
Provision (benefit) for income taxes	19	—
	3,882	3,488
Net income	\$ 3,882	\$ 3,488

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, 2004	\$ 354	\$ 2,114	\$ 28,250	\$ 63,302	\$ (399)	\$ 93,621
Net income				3,488		3,488
Protected borrower equity retired	(50)					(50)
Capital stock/participation certificates issued		102				102
Capital stock/participation certificates retired		(45)				(45)
Retained earnings retired			(6,212)			(6,212)
Distribution adjustment			—	33		33
Balance at March 31, 2005	\$ 304	\$ 2,171	\$ 22,038	\$ 66,823	\$ (399)	\$ 90,937
Balance at December 31, 2005	\$ 269	\$ 2,154	\$ 22,035	\$ 72,268	\$ (404)	\$ 96,322
Net income				3,882		3,882
Protected borrower equity retired	(48)					(48)
Capital stock/participation certificates issued		98				98
Capital stock/participation certificates retired		(64)				(64)
Retained earnings retired			(6,121)			(6,121)
Distribution adjustment			3	151		154
Balance at March 31, 2006	\$ 221	\$ 2,188	\$ 15,917	\$ 76,301	\$ (404)	\$ 94,223

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, 2005, are contained in the 2005 Annual Report to Shareholders. These unaudited first quarter 2006 consolidated financial statements should be read in conjunction with the 2005 Annual Report to Shareholders.

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 three months ended March 31, 2006, are not necessarily indicative of the results to be expected for the year ending December 31, 2006.

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

The Association maintains an allowance for loan losses in accordance with generally accepted accounting principles. The loan portfolio is reviewed quarterly to determine the adequacy of the allowance for losses. As of March 31, 2006, the allowance for losses is adequate in management's opinion to provide for possible losses on existing loans.

NOTE 2 – ALLOWANCE FOR LOAN LOSSES

An analysis of the allowance for loan losses follows:

Balance at 12-31-04	\$ 3,507
(Reversal of) provision for loan losses	—
Recoveries, net of loans charged off	5
Balance at 3-31-05	<u>\$ 3,512</u>
Balance at 12-31-05	\$ 3,434
(Reversal of) provision for loan losses	—
Recoveries, net of loans charged off	—
Balance at 3-31-06	<u>\$ 3,434</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 three months ended March 31, 2006:

	For the three months ended March 31,	
	2006	2005
Pension	\$ 188	\$ 186
Thrift/deferred compensation	44	47
Other postretirement benefits	100	154
Total	<u>\$ 332</u>	<u>\$ 387</u>

As of March 31, 2006, no contributions have been made to the pension plan for 2006. Actuarial projections as of the last plan measurement date (September 30, 2005) did not anticipate any contributions for 2006; however, market conditions could impact discount rates and return on plan assets which could change this expectation, making contributions necessary before the next plan measurement date.

The Association also sponsors a supplemental retirement plan for certain key employees. The expenses of this plan are included in the pension costs above. The Association contributed \$7 to this plan during the first three months of 2006. The Association anticipates making additional contributions of \$21 to the supplemental retirement plan during the remainder of 2006.