

THIRD QUARTER 2005

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Richard A. Eason
Chief Executive Officer



Ronald J. Allen
Chairman of the Board

October 28, 2005

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

The following commentary reviews the financial condition and results of operations of Cape Fear Farm Credit ACA, (Association) for the period ended September 30, 2005. These comments should be read in conjunction with the accompanying consolidated financial statements, notes to the consolidated financial statements and the 2004 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 September 30, 2005, was \$532,567, an increase of \$60,347 as compared to \$476,220 at December 31, 2004. Net loans outstanding at September 30, 2005, were \$529,133 as compared to \$472,713 at December 31, 2004. Net loans accounted for 94.55 percent of total assets at September 30, 2005, as compared to 94.23 percent of total assets at December 31, 2004.

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 \$1,399 at December 31, 2004, to \$1,991 at September 30, 2005. This increase results primarily from the transfer of one loan to nonaccrual status.

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, 2005, was \$3,434 compared to \$3,507 at December 31, 2004, and was considered by management to be adequate to cover possible losses. The decline results primarily from a reduction in the allowance based on updated analysis of risk in the loan portfolio.

RESULTS OF OPERATIONS

For the three months ended September 30, 2005

Net income for the three months ended September 30, 2005, totaled \$3,506 as compared to \$3,234 for the same period in 2004. The increase of \$272 or 8.41 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 September 30, 2005, increased \$725 or 20.36 percent compared to September 30, 2004. Interest income on loans increased by \$2,272 while interest expense increased \$1,547 compared to the same period last year, both due primarily to increases in market interest rates. Nonaccrual income was \$13 for the three months ended September 30, 2005, as compared to \$20 for the same period in 2004.

Noninterest income for the three months ended September 30, 2005, totaled \$1,726 as compared to \$1,740 for the same period of 2004, a decline of \$14. The decline resulted from a decline of \$30 in patronage earnings from AgFirst Farm Credit Bank (Bank), and a decline of \$165 in other noninterest income, offset in part by an increase in loan fee income of \$181.

Noninterest expense for the three months ended September 30, 2005, increased \$273 compared to the same period of 2004. This increase resulted primarily from an increase of \$142 in Insurance Fund premium, an increase of \$79 in other operating expense, and an increase in salaries and employee benefits of \$62, which was offset in part by a decline in occupancy and equipment expense of \$10.

For the nine months ended September 30, 2005

Net income for the nine months ended September 30, 2005, totaled \$10,490 as compared to \$10,146 for the same period in 2004. The increase of \$344 or 3.39 percent is attributed primarily to an increase in net interest income resulting from growth in loan volume and an increase in market interest rates.

At September 30, 2005, net interest income increased \$941 or 8.26 percent compared to September 30, 2004. Interest income on loans increased by \$4,324 while interest expense increased \$3,718 compared to the same period last year, both due primarily to increases in market interest rates. Nonaccrual income was \$255 for the nine months ended September 30, 2005, as compared to \$575 for the same period in 2004.

Noninterest income for the nine months ended September 30, 2005, totaled \$5,075 as compared to \$5,119 for the same period of 2004, a decline of \$44. The decline resulted from a decline of \$234 in patronage earnings from the Bank, a decline of \$204 in other noninterest income, offset in part by an increase in loan fee income of \$348 and an increase of \$46 in fees for financially related services.

Noninterest expense for the nine months ended September 30, 2005, increased \$327 compared to the same period of 2004. This increase resulted primarily from an increase of \$84 in salaries and benefits, an increase of \$247 in other operating expense, and an increase in Insurance Fund premium of \$3. These increases were offset in part by a decline of \$7 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, 2005, were \$452,153 as compared to \$393,652 at December 31, 2004.

CAPITAL RESOURCES

Total members' equity at September 30, 2005, increased to \$97,885 from the December 31, 2004, total of \$93,621. 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, 2005, the Association's total surplus ratio and core surplus ratio were 16.16 percent and 12.84 percent, respectively, and the permanent capital ratio was 16.56 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>	September 30, 2005 <i>(unaudited)</i>	December 31, 2004 <i>(audited)</i>
Assets		
Cash	\$ 1,909	\$ 2,052
Loans	532,567	476,220
Less: allowance for loan losses	3,434	3,507
Net loans	529,133	472,713
Accrued interest receivable	9,474	5,466
Investment in other Farm Credit institutions	6,009	6,009
Premises and equipment, net	3,367	3,472
Other assets	9,762	11,932
Total assets	\$ 559,654	\$ 501,644
Liabilities		
Notes payable to AgFirst Farm Credit Bank	\$ 452,153	\$ 393,652
Accrued interest payable	1,760	1,277
Patronage refund payable	72	5,553
Other liabilities	7,784	7,541
Total liabilities	461,769	408,023
Commitments and contingencies		
Members' Equity		
Protected borrower equity	281	354
Capital stock and participation certificates	2,142	2,114
Retained earnings		
Allocated	22,035	28,250
Unallocated	73,826	63,302
Accumulated other comprehensive income (loss)	(399)	(399)
Total members' equity	97,885	93,621
Total liabilities and members' equity	\$ 559,654	\$ 501,644

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,	
	2005	2004	2005	2004
Interest Income				
Loans	\$ 9,413	\$ 7,141	\$ 25,741	\$ 21,417
Interest Expense				
Notes payable to AgFirst Farm Credit Bank	5,127	3,580	13,476	10,028
Net interest income	4,286	3,561	12,265	11,389
Provision for (reversal of) loan losses	—	—	(65)	—
Net interest income after provision for (reversal of) loan losses	4,286	3,561	12,330	11,389
Noninterest Income				
Loan fees	566	385	1,772	1,424
Fees for financially related services	122	123	281	235
Equity in earnings of other Farm Credit institutions	1,018	1,048	2,902	3,136
Gains (losses) on other property owned, net	2	1	6	6
Other noninterest income	18	183	114	318
Total noninterest income	1,726	1,740	5,075	5,119
Noninterest Expense				
Salaries and employee benefits	1,782	1,720	4,845	4,761
Occupancy and equipment	210	220	546	553
Insurance Fund premium	87	(55)	179	176
Other operating expenses	427	348	1,285	1,038
Total noninterest expense	2,506	2,233	6,855	6,528
Income before income taxes	3,506	3,068	10,550	9,980
Provision (benefit) for income taxes	—	(166)	60	(166)
Net income	\$ 3,506	\$ 3,234	\$ 10,490	\$ 10,146

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, 2003	\$ 489	\$ 2,057	\$ 35,025	\$ 47,532	\$ (4,497)	\$ 80,606
Net income				10,146		10,146
Protected borrower equity retired	(122)					(122)
Capital stock/participation certificates issued		162				162
Capital stock/participation certificates retired		(124)				(124)
Retained earnings retired			(6,732)			(6,732)
Distribution adjustment			(38)	59		21
Balance at September 30, 2004	\$ 367	\$ 2,095	\$ 28,255	\$ 57,737	\$ (4,497)	\$ 83,957
Balance at December 31, 2004	\$ 354	\$ 2,114	\$ 28,250	\$ 63,302	\$ (399)	\$ 93,621
Net income				10,490		10,490
Protected borrower equity retired	(73)					(73)
Capital stock/participation certificates issued		280				280
Capital stock/participation certificates retired		(252)				(252)
Retained earnings retired			(6,236)			(6,236)
Distribution adjustment			21	34		55
Balance at September 30, 2005	\$ 281	\$ 2,142	\$ 22,035	\$ 73,826	\$ (399)	\$ 97,885

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, 2004, are contained in the 2004 Annual Report to Shareholders. These unaudited third quarter 2005 consolidated financial statements should be read in conjunction with the 2004 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 nine months ended September 30, 2005, are not necessarily indicative of the results to be expected for the year ending December 31, 2005.

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 September 30, 2005, 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 12-31-03	\$ 9,993
(Reversal of) provision for loan losses	—
Recoveries, net of loans charged off	10
Balance at 9-30-04	\$ 10,003
Balance at 12-31-04	\$ 3,507
(Reversal of) provision for loan losses	(65)
Loans (charged off), net of recoveries	(8)
Balance at 9-30-05	\$ 3,434

As discussed in the 2004 Annual Report, the Association recorded a loan loss reversal of \$6,497 in the fourth quarter of 2004 that resulted in a decrease in the allowance for loan losses.

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, 2005:

	For the nine months ended September 30,	
	2005	2004
Pension	\$ 559	\$ 605
Thrift/deferred compensation	102	82
Other postretirement benefits	463	523
Total	\$1,124	\$1,210

The Association had not previously anticipated making a contribution in 2005 to the defined benefit retirement plan based upon actuarial projections as of the last plan measurement date (September 30, 2004). However, due to market conditions affecting discount rates and return on plan assets, current actuarial projections indicated that a contribution was needed to meet the expected accumulated benefit obligation at September 30, 2005. During the third quarter of 2005, the Association contributed \$1,008 to the defined benefit retirement plan. The Association does not anticipate making additional contributions for the remainder of 2005.

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 2005. The Association anticipates making additional contributions of \$7 to the supplemental retirement plan during the remainder of 2005.