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

FORM 10-Q

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

For the quarterly period ended September 30, 2005

NTS MORTGAGE INCOME FUND

(Exact name of registrant as specified in its charter)

Delaware

(State of incorporation or organization)

0-18550

(Commission File No.)

61-1146077

(I.R.S. Employer Identification No.)

10172 Linn Station Road

Louisville, Kentucky 40223

(Address of principal executive offices)

(502) 426-4800

(Registrant's telephone number, including area code)

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 registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

As of November 1, 2005, the registrant had approximately 3,187,000 shares of common stock outstanding.

NTS MORTGAGE INCOME FUND

FORM 10-Q

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INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

Some of the statements included in this quarterly report on Form 10-Q, particularly those included in Part I, Item 2 – Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”), may be considered “forward-looking statements” because the statements relate to matters which have not yet occurred. For example, phrases such as “we anticipate,” “believe” or “expect” indicate that it is possible that the event anticipated, believed or expected may not occur. If these events do not occur, the result which we expected also may, or may not, occur in a different manner, which may be more or less favorable to us. We do not undertake any obligation to update these forward-looking statements.

Any forward-looking statements included in MD&A, or elsewhere in this report, reflect our best judgment based on known factors, but involve risks and uncertainties. Actual results could differ materially from those anticipated in any forward-looking statements as a result of a number of factors, including but not limited to those described in our filings with the Securities and Exchange Commission. Any forward-looking information provided by us pursuant to the safe harbor established by the Private Securities Litigation Reform Act of 1995 should be evaluated in the context of these factors.

PART I - FINANCIAL INFORMATION
ITEM 1 - CONSOLIDATED FINANCIAL STATEMENTS

NTS MORTGAGE INCOME FUND

Consolidated Balance Sheets as of September 30, 2005 and December 31, 2004

	<u>(Unaudited)</u> <u>September 30,</u> <u>2005</u>	<u>December 31,</u> <u>2004</u>
ASSETS:		
Cash and equivalents	\$ 1,489,379	\$ 1,309,537
Membership initiation fees and other accounts receivable, net of allowance of approximately \$114,000 and \$134,000, respectively	551,502	519,016
Notes receivable.....	485,726	545,055
Inventory	23,421,596	26,637,219
Property and equipment, net of accumulated depreciation of approximately \$1,488,000 and \$1,371,000, respectively	3,135,332	3,187,785
Investment in unconsolidated affiliate	2,785,157	2,265,179
Other assets.....	<u>317,664</u>	<u>236,569</u>
Total assets	<u>\$ 32,186,356</u>	<u>\$ 34,700,360</u>
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Accounts payable and accrued expenses.....	\$ 2,601,896	\$ 1,801,897
Accounts payable and accrued expenses - affiliates.....	8,936,218	13,087,453
Mortgage and notes payable	403,068	1,831,975
Other liabilities	<u>656,462</u>	<u>341,080</u>
Total liabilities	12,597,644	17,062,405
COMMITMENTS AND CONTINGENCIES (NOTE 16)		
STOCKHOLDERS' EQUITY		
Common stock, \$0.001 par value, 6,000,000 shares authorized; 3,187,333 shares issued and outstanding	3,187	3,187
Additional paid-in-capital	54,163,397	54,163,397
Accumulated deficit.....	<u>(34,577,872)</u>	<u>(36,528,629)</u>
Total stockholders' equity	<u>19,588,712</u>	<u>17,637,955</u>
Total liabilities and stockholders' equity	<u>\$ 32,186,356</u>	<u>\$ 34,700,360</u>

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

NTS MORTGAGE INCOME FUND

Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2005 and 2004
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
REVENUE:				
Lot sales, net of discounts	\$ 2,543,290	\$ 2,945,336	\$ 14,005,083	\$ 11,747,070
Cost of sales	<u>1,015,344</u>	<u>2,399,498</u>	<u>8,574,257</u>	<u>9,596,592</u>
Gross profit	<u>1,527,946</u>	<u>545,838</u>	<u>5,430,826</u>	<u>2,150,478</u>
Country Club revenue	539,704	510,074	1,389,712	1,262,450
Interest income on cash equivalents and miscellaneous income	<u>17,007</u>	<u>10,756</u>	<u>45,113</u>	<u>58,377</u>
Total revenues	<u>2,084,657</u>	<u>1,066,668</u>	<u>6,865,651</u>	<u>3,471,305</u>
EXPENSES:				
Selling, general and administrative - affiliates	525,169	394,582	1,817,996	1,496,915
Selling, general and administrative	432,183	429,885	1,391,961	1,260,128
Interest expense	-	69	-	357
Other taxes and licenses	20,525	34,035	73,643	71,529
Depreciation and amortization	23,292	26,725	73,174	86,387
Country Club operations	<u>742,777</u>	<u>802,809</u>	<u>2,078,098</u>	<u>1,962,323</u>
Total operating expenses	<u>1,743,946</u>	<u>1,688,105</u>	<u>5,434,872</u>	<u>4,877,639</u>
Income (loss) before other income and income taxes	340,711	(621,437)	1,430,779	(1,406,334)
Income (loss) from investments in unconsolidated affiliate	<u>81,840</u>	<u>(12,477)</u>	<u>519,978</u>	<u>257,886</u>
Income (loss) before income taxes	422,551	(633,914)	1,950,757	(1,148,448)
Income taxes	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
NET INCOME (LOSS)	<u>\$ 422,551</u>	<u>\$ (633,914)</u>	<u>\$ 1,950,757</u>	<u>\$ (1,148,448)</u>
NET INCOME (LOSS) PER SHARE OF COMMON STOCK	<u>\$ 0.13</u>	<u>\$ (0.20)</u>	<u>\$ 0.61</u>	<u>\$ (0.36)</u>
Weighted average number of shares	<u>3,187,333</u>	<u>3,187,333</u>	<u>3,187,333</u>	<u>3,187,333</u>

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

NTS MORTGAGE INCOME FUND

*Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2005 and 2004
(Unaudited)*

	Nine Months Ended September 30,	
	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 1,950,757	\$ (1,148,448)
Adjustments to reconcile net income and loss to net cash provided by operating activities:		
Depreciation and amortization expense	73,174	86,387
Income from investment in unconsolidated affiliate	(519,978)	(257,886)
Changes in assets and liabilities:		
Membership initiation fees and other accounts receivable	(32,486)	141,603
Notes receivable	59,329	198,272
Inventory	3,304,939	4,594,191
Accounts payable and accrued expenses	799,999	(677,822)
Other liabilities	315,382	87,231
Other assets	(127,181)	(81,315)
Net cash provided by operating activities	5,823,935	2,942,213
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(63,951)	(157,630)
Net cash used in investing activities	(63,951)	(157,630)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Accounts payable and accrued expenses - affiliates	(4,151,235)	1,714,346
Proceeds from mortgages and notes payable	4,306,517	8,932,249
Payments on mortgages and notes payable	(5,735,424)	(13,378,306)
Net cash used in financing activities	(5,580,142)	(2,731,711)
NET INCREASE IN CASH AND EQUIVALENTS	179,842	52,872
CASH AND EQUIVALENTS, beginning of period	1,309,537	889,675
CASH AND EQUIVALENTS, end of period	\$ 1,489,379	\$ 942,547

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

NTS MORTGAGE INCOME FUND
Notes to Consolidated Financial Statements
(Unaudited)

The unaudited consolidated financial statements included herein should be read in conjunction with NTS Mortgage Income Fund's (the "Fund") 2004 annual report on Form 10-K as filed with the Securities and Exchange Commission on March 30, 2005. In the opinion of the Fund's management, all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation have been made to the accompanying consolidated financial statements for the three and nine months ended September 30, 2005 and 2004. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year or any other interim period. As used in this quarterly report on Form 10-Q the terms "we," "us" or "our," as the context requires, may refer to the Fund or its interests in its properties and joint venture.

Note 1 - Organization

The Fund, a Delaware corporation, was formed on September 26, 1988. The Fund operated as a real estate investment trust under the Internal Revenue Code of 1986 (the "Code"), as amended, from its inception through December 31, 1996. The Fund began operating as a "C" corporation under the Code for tax purposes effective January 1, 1997. NTS Corporation is the sponsor of the Fund (the "Sponsor"), NTS Advisory Corporation is the advisor to the Fund (the "Advisor"), and NTS Residential Management Company and its successor under assignment, Residential Management Company, is the manager to the Fund ("NTS Management"). The Advisor and NTS Management are affiliates of and are under common control with NTS Corporation.

Our wholly-owned subsidiaries include NTS/Lake Forest II Residential Corporation ("NTS/LFII") and NTS/Virginia Development Company ("NTS/VA").

We are a finite life entity. Our organizational documents require us to commence an orderly liquidation by December 31, 2008. Delaware law, our state of incorporation, provides us with a three-year period after the initiation of our liquidation to wind up our affairs and issue final distributions to shareholders.

NTS/LFII is in the process of developing approximately 1,109 residential lots of land located in Louisville, Kentucky into a single-family residential community (Lake Forest). Lake Forest has amenities consisting of a clubhouse, pools, tennis courts, recreation fields and several lakes and a country club with a championship golf course.

NTS/VA is in the process of developing approximately 1,398 residential lots of land located in the Chancellor District of Spotsylvania County, Virginia, approximately 60 miles south of Washington D.C., into a single-family residential community (Fawn Lake) and has completed a country club with a championship golf course for the purpose of selling such residential lots and country club memberships. Fawn Lake has amenities consisting of a 285-acre lake, clubhouse, pool, tennis courts and boat docks.

We also own a 50% interest in the Orlando Lake Forest Joint Venture (the "Joint Venture"). See Note 10 - Investment in Unconsolidated Affiliate for further information pertaining to the investment.

Note 2 - Basis of Accounting

Our records are maintained on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles.

Note 3 - Principles of Consolidation and Basis of Presentation

Our consolidated financial statements include the assets, liabilities, revenues and expenses of our wholly-owned subsidiaries (see Note 1). Investments of 50% or less in affiliated companies are accounted for under the equity method. All significant intercompany transactions and balances have been eliminated.

Note 4 - Use of Estimates in the Preparation of Consolidated Financial Statements

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Note 5 - Cash and Equivalents

Cash and equivalents include cash on hand and short-term, highly liquid investments with initial maturities of three months or less.

Note 6 - Financial Instruments

The book values of cash and equivalents, trade receivables and trade payables are considered to be representative of their respective fair values because of the immediate or short-term maturity of these financial instruments. The fair value of our notes receivable and debt instruments approximated their book value because a substantial portion of the underlying instruments are variable rate notes.

Note 7 - Inventory

Inventory is stated at the lower of cost or net realizable value. Inventory includes all direct costs of land, land development, and amenities, including interest, real estate taxes, and certain other costs incurred during the development period including marketing costs of initial membership sales of the Lake Forest Country Club, less amounts charged to cost of sales. Inventory costs are allocated to individual lots sold using their relative sales values. The use of the relative sales value method to record cost of sales requires the use of estimates of sales values, development costs (net of country club initiation fees) and absorption periods over the life of the project. Given the long-term nature of the projects and inherent economic volatility of residential real estate and the use of estimates to determine sales values, development costs and absorption periods, it is reasonably possible that such estimates could change in the near term. Any changes in estimates are accounted for prospectively over the life of the project.

Inventory consists of approximately the following as of September 30, 2005:

		<i>(Unaudited)</i>	
	<i>NTS/LFII</i>	<i>NTS/VA</i>	<i>Consolidated</i>
Land held for future development, under development and completed lots.....	\$ 389,000	\$ 15,039,000	\$ 15,428,000
Country Club (net of \$9,205,000 membership initiation fees)	23,000	-	23,000
Amenities.....	14,000	7,957,000	7,971,000
	<u>\$ 426,000</u>	<u>\$ 22,996,000</u>	<u>\$ 23,422,000</u>

Items capitalized to inventory for the nine months ended September 30, 2005

Capitalized interest	\$ <u>2,000</u>	\$ <u>73,000</u>	\$ <u>75,000</u>
Capitalized property taxes.....	\$ <u>7,000</u>	\$ <u>143,000</u>	\$ <u>150,000</u>

Inventory consists of approximately the following as of December 31, 2004:

	<u>NTS/LFII</u>	<u>NTS/VA</u>	<u>Consolidated</u>
Land held for future development, under development and completed lots.....	\$ 283,000	\$ 16,678,000	\$ 16,961,000
Country Club (net of \$9,134,000 membership initiation fees)	219,000	-	219,000
Amenities.....	<u>54,000</u>	<u>9,403,000</u>	<u>9,457,000</u>
	<u>\$ 556,000</u>	<u>\$ 26,081,000</u>	<u>\$ 26,637,000</u>

Items capitalized to inventory in 2004

Capitalized interest	\$ <u>3,000</u>	\$ <u>374,000</u>	\$ <u>377,000</u>
Capitalized property taxes.....	\$ <u>10,000</u>	\$ <u>188,000</u>	\$ <u>198,000</u>

The amenities for NTS/LFII and NTS/VA include all common areas, entrance walls, lakes and dams, a maintenance facility, clubhouses, golf courses, swimming pools, tennis courts, sports fields and parks.

Pursuant to the Membership Marketing Agreement, dated June 7, 2004, between NTS/LFII and the Lake Forest Country Club, NTS/LFII is to receive 50% of initiation fees from the initial issuance of the remaining initial memberships to the Country Club. As long as the agreement is in effect, we expect that we will not incur any marketing or selling expenses related to issuance of initial memberships. We are not responsible for any refund related to any issued memberships. On December 28, 2003, the Lake Forest Country Club ownership and operations were turned over to its members.

Note 8 – Property and Equipment

The following schedule provides an analysis of our approximate investment in property and equipment:

	<u>(Unaudited)</u> <u>September 30,</u> <u>2005</u>	<u>December 31,</u> <u>2004</u>
Land and buildings	\$ 3,326,000	\$ 3,313,000
Equipment.....	<u>1,297,000</u>	<u>1,246,000</u>
	4,623,000	4,559,000
Less accumulated depreciation	<u>1,488,000</u>	<u>1,371,000</u>
	<u>\$ 3,135,000</u>	<u>\$ 3,188,000</u>

Note 9 - Long-Lived Assets

Statement of Financial Accounting Standards (“SFAS”) No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets,” specifies circumstances in which certain long-lived assets must be reviewed for impairment. If the carrying amount of an asset exceeds the sum of its expected future cash flows, the asset’s carrying value must be written down to fair value. There were no impairment losses during any of the periods presented.

Note 10 - Investment in Unconsolidated Affiliate

Effective August 16, 1997, we became a partner in the Joint Venture. The other partners in the Joint Venture are Orlando Lake Forest, Inc., Orlando Capital Corporation and OLF II Corporation, all of whom are affiliates of and are under common control with the Fund's Sponsor. The Joint Venture will continue to operate under its current legal name as the Orlando Lake Forest Joint Venture.

The Joint Venture owns the Orlando Lake Forest project, a single-family residential community located in Seminole County, Florida (near Orlando) consisting of approximately 360 acres of residential land and improvements and approximately 20 acres of commercial land. The Joint Venture will continue to own and develop the Orlando Lake Forest project.

We contributed to the Joint Venture as a capital contribution our interest in the principal and interest of the first mortgage loan on the Orlando Lake Forest project, and obtained a 50% interest in the Joint Venture. The NTS entities named above hold cumulatively the remaining 50% interest in the Joint Venture.

The net income or net loss of the Joint Venture is allocated based on the respective partner's percentage interest, as defined in the joint venture agreement. As of September 30, 2005 and December 31, 2004, our percentage interest was 50%, and our investment balance in the Joint Venture was approximately \$2,785,000 and \$2,265,000, respectively. Our share of the Joint Venture's net income for the three and nine months ended September 30, 2005 was approximately \$82,000 and \$520,000, respectively. Our share of the Joint Venture's net (loss) income for the three and nine months ended September 30, 2004 was approximately \$(12,000) and \$258,000, respectively.

Presented below are approximate condensed balance sheets for the Joint Venture as of September 30, 2005 and December 31, 2004, and approximate condensed statements of operations for the three and nine months ended September 30, 2005 and 2004:

	<i>(Unaudited)</i> <i>September 30,</i> <i>2005</i>	<i>December 31,</i> <i>2004</i>
Condensed Balance Sheets		
Inventory.....	\$ 2,348,000	\$ 3,262,000
Other, net	<u>3,519,000</u>	<u>2,323,000</u>
Total assets	\$ <u>5,867,000</u>	\$ <u>5,585,000</u>
Liabilities.....	\$ 297,000	\$ 1,055,000
Equity	<u>5,570,000</u>	<u>4,530,000</u>
Total liabilities and equity	\$ <u><u>5,867,000</u></u>	\$ <u><u>5,585,000</u></u>

	<i>(Unaudited)</i>		<i>(Unaudited)</i>	
	<i>Three Months Ended</i>		<i>Nine Months Ended</i>	
	<i>September 30,</i>		<i>September 30,</i>	
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
Condensed Statements of Operations				
Lot sales, net of discounts.....	\$ 560,000	\$ 605,000	\$ 3,390,000	\$ 4,890,000
Cost of sales.....	(315,000)	(422,000)	(1,804,000)	(3,421,000)
Other expenses, net.....	(81,000)	(208,000)	(546,000)	(953,000)
Net income (loss)	\$ 164,000	\$ (25,000)	\$ 1,040,000	\$ 516,000

Note 11 - Mortgage and Notes Payable

Mortgage and notes payable consist of the following:

	<i>(Unaudited)</i>	
	<i>September 30,</i>	<i>December 31,</i>
	<i>2005</i>	<i>2004</i>
Note payable to a bank in the amount of \$9,000,000, bearing interest at 8.25%, payable monthly, due May 1, 2006, secured by a \$3,701,155 Certificate of Deposit owned by NTS Financial Partnership, an affiliate of the Fund.	\$ -	\$ 1,405,810
Warehouse line of credit agreement with a bank, bearing interest at the Prime Rate + .75% , due June 15, 2006, secured by notes receivable, principal payments consist of payments received from notes receivable securing the obligation.....	278,863	297,979
Other.....	124,205	128,186
	<u>\$ 403,068</u>	<u>\$ 1,831,975</u>

We anticipate seeking renewals or refinancing the debts coming due within the next twelve months with our existing creditors, however, there can be no assurances that we will be successful in doing so. The Prime Rate was 6.75% on September 30, 2005 and 5.25% on December 31, 2004.

We recently amended and restated our mortgage loan due May 1, 2006. It is secured by approximately 500 acres of undeveloped land at the NTS/VA project. All previous security and collateral pledges were released. Paydowns from lot sales are no longer required. The loan is a revolver, with \$300,000 of the credit commitment set aside as an interest reserve. The maximum amount outstanding at any time shall be no greater than \$4,700,000. The balance was \$0 on September 30, 2005 and December 31, 2004.

Note 12 - Revenue Recognition and Cost of Sales

We recognize revenue and related costs from lot sales using the accrual method in accordance with U.S. generally accepted accounting principles, which is when payment has been received and title, possession and other attributes of ownership have been transferred to the buyer, and we are not obligated to perform significant activities after the sale. The country club recognizes operating revenue as services are performed.

We calculate our costs of sales using a percentage based on estimates of total sales and project costs, principally acquisition and development costs. We estimate cost of sales percentages at the end of each fiscal year, and the resulting cost of sales percentages are applied prospectively. Total estimates are based on an analysis of actual costs incurred to date and the estimated costs of completion. Adjustments to estimated total project sales and development costs for the project affect the cost of goods sold percentage. The difference in the cost of sales percentage of NTS/LFII compared to NTS/VA and the difference in the lot sales mix will create a proportionate change in the combined gross profit margin throughout a given year. Costs of sales for a specific period also include direct selling costs, such as those relating to sales concessions, incurred during the period. These costs are not included in the estimated cost of sales percentage.

Note 13 - Related Party Transactions

During 2004, an affiliate of the Fund, Cedar Creek Virginia LLC, entered into an agreement to purchase 13 lots from the Fund for the purpose of building homes on speculation for sale to individuals. Cedar Creek Virginia LLC is partially owned by J.D. Nichols and Brian F. Lavin, our Chairman and President, respectively. The Fund has deferred the actual sale of these lots until final closing where each home would be sold to an individual purchaser. The lot price in the agreement was determined by comparing the sales price of competitive lots within the NTS/VA Fawn Lake Development. A total of 12 lots have been sold to individual purchasers for a total of \$995,000 as of September 30, 2005 under this agreement.

As of September 30, 2005, the Sponsor or an affiliate owned approximately 637,000 shares of the Fund. The Fund has entered into the following agreements with various affiliates of the Sponsor regarding the ongoing operation of the Fund.

Property Management Agreements

The ongoing operation and management of the Lake Forest North and Fawn Lake projects will be conducted by NTS Management under the terms of (i) a property management agreement executed on December 30, 1997, and dated as of October 1, 1997, by and among the Fund, NTS/LFII and NTS Residential Management Company for the Lake Forest North project, and (ii) a property management agreement executed on December 30, 1997, and dated as of October 1, 1997, by and among the Fund, NTS/VA and NTS Residential Management Company for the Fawn Lake project (collectively, the "Management Agreements"). NTS Development Company ("NTS Development") is a wholly-owned subsidiary of the Fund's Sponsor. The Management Agreements have been renewed through December 31, 2008. Under the Management Agreements, NTS Management will be reimbursed for costs incurred in the operation and management of the Lake Forest North and Fawn Lake projects, will be entitled to an overhead recovery and will accrue an incentive payment payable as provided therein.

These expense reimbursements include direct and pro-rated costs incurred in the management and operation of NTS/LFII and NTS/VA. Such costs include compensation costs of management, accounting, professional, engineering and development, marketing and office personnel employed by NTS Management and/or certain of its affiliates as well as various non-payroll related operating expenses. Compensation costs are for those individuals who rendered services full time and on site at the residential projects and with respect to the residential projects, but who have multiple residential projects responsibilities some of which may be affiliated entities of NTS Management. For services provided by individuals not on site, or those with multiple residential project responsibilities, costs are pro-rated by NTS Management and allocated to the appropriate residential project. As permitted by the property management agreements, we were charged the following amounts for the three and nine months ended September 30, 2005 and 2004. These amounts are reflected in selling, general and administrative - affiliates on the accompanying consolidated statements of operations in accordance with the Management Agreements.

	<i>(Unaudited)</i>		<i>(Unaudited)</i>	
	<i>Three Months Ended</i>		<i>Nine Months Ended</i>	
	<i>September 30,</i>		<i>September 30,</i>	
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
Personnel Related Costs				
Financing and accounting	\$ 75,000	\$ 65,000	\$ 235,000	\$ 202,000
Data processing	5,000	7,000	16,000	22,000
Human resources	17,000	14,000	52,000	40,000
Executive and administrative services	48,000	34,000	144,000	102,000
Construction management	1,000	-	2,000	-
Sales and marketing	243,000	137,000	723,000	617,000
Legal	28,000	14,000	87,000	42,000
Total personnel related costs	417,000	271,000	1,259,000	1,025,000
Rent	7,000	5,000	19,000	16,000
Total expense reimbursements	\$ 424,000	\$ 276,000	\$ 1,278,000	\$ 1,041,000

Additionally, NTS Management is entitled to an overhead recovery, which is a reimbursement for overhead expenses attributable to the employees and the efforts of NTS Management under the Management Agreements, in an amount equal to 3.75% of the projects' gross cash receipts, as defined in the Management Agreements. Overhead recovery for the three and nine months ended September 30, 2005 was approximately \$101,000 and \$540,000, respectively. Overhead recovery for the three and nine months ended September 30, 2004 was approximately \$119,000 and \$457,000, respectively. These amounts are classified with selling, general and administrative-affiliates in the accompanying consolidated statements of operations.

There were also expense reimbursements of approximately \$1,107,000 and \$891,000 accrued to NTS Management or an affiliate during the nine months ended September 30, 2005 and 2004, respectively, for Fawn Lake Country Club. Such costs include compensation costs of management, golf course maintenance, golf professional, kitchen personnel, and accounting as well as various non-payroll related operating expenses. In addition, there were overhead recovery fees of approximately \$51,000 and \$47,000 accrued to NTS Management for overhead recovery fees at Fawn Lake Country Club for the nine months ended September 30, 2005 and 2004.

The Management Agreements also call for NTS Management to potentially receive an incentive payment, as defined in the Management Agreements, equal to 10% of the net cash flows of the projects. The incentive payment will not begin accruing until after the cumulative cash flows of NTS/LFII, NTS/VA and the Fund's share of the cash flow of the Joint Venture would have been sufficient to enable us to have returned to the then existing shareholders of the Fund an amount which, after adding thereto all other payments actually remitted or distributed to such shareholders of the Fund, is at least equal to the shareholders' original capital contribution. As of September 30, 2005, we had raised approximately \$63,690,000 and had paid distributions of approximately \$23,141,000. As of September 30, 2005, no amount had been accrued as an incentive payment in our consolidated financial statements.

On July 1, 2005, NTS Residential Management Company assigned its responsibilities and right to receive certain payments (for items accrued after July 1, 2005) under the management agreements to Residential Management Company. The assignment does not relieve NTS Residential Management Company from its rights or duties and obligations to perform its responsibilities under the management agreements. Residential Management Company is owned by our Chairman J.D. Nichols and President Brian F. Lavin. NTS Corporation owns NTS Residential Management Company with a similar ownership and control structure.

Sale of Undeveloped Land

On March 6, 2001, NTS/LFII sold 26.5 acres of land to Lake Forest Fairways, LLC ("Fairways"), a limited liability company which was formed between NTS Development and Fairway Development, LLC (an unaffiliated third party). The initial payment was made on March 6, 2001 for \$30,000 per acre for a total of \$795,000. Fairways will also pay NTS/LFII at each closing of the sale of the first 100 home units, as an additional component of the purchase price for the property, the sum of \$14,500 per home unit sold. The sale has been recorded using the cost recovery method and the transaction has been recorded for a total sales value of \$1,715,000, consisting of the initial payment at closing for \$795,000 and the gross future proceeds of \$1,450,000 which are discounted to a net present value \$920,000. Under the cost recovery method, no profit is recognized until cash payments by the buyer (Fairways) exceed the seller's (NTS/LFII) cost of the property sold. This unrecognized profit is offset against the receivable on the balance sheet. The receivable balance related to this sale was approximately \$65,000 and \$123,000, on September 30, 2005 and December 31, 2004, respectively. The transactional values were derived from an independent appraisal performed by Integra Chapman & Bell dated January 4, 2000.

Accounts Payable and Accrued Expenses - Affiliates

As of September 30, 2005, we owed approximately \$8,936,000 to NTS Development, NTS Residential Management Company and Residential Management Company for salary and overhead reimbursements included in accounts payable and accrued expenses - affiliates.

NTS Development and NTS Management have agreed to defer, until March 31, 2006, amounts owed to them by us as of December 31, 2004 and those amounts accruing from January 1, 2005 through March 31, 2006, other than as permitted by our cash flows. There can be no assurances that NTS Development and NTS Management will continue to defer amounts due them past March 31, 2006.

Note 14 - Country Club Accounting

Presented below are the approximate condensed statements of operations for the Fawn Lake Country Club for the three and nine months ended September 30, 2005 and 2004:

	<i>(Unaudited)</i>	
	<i>Three Months Ended</i>	
	<i>September 30,</i>	
	<i>2005</i>	<i>2004</i>
Condensed Statements of Operations		
Revenues:		
Operating revenues	\$ 540,000	\$ 510,000
Total revenues	540,000	510,000
Expenses:		
Cost of goods sold	105,000	106,000
Selling, general and administrative - affiliates.....	399,000	376,000
Selling, general and administrative	205,000	288,000
Depreciation.....	34,000	33,000
Total expenses	743,000	803,000
Net loss	\$ (203,000)	\$ (293,000)

		<i>(Unaudited)</i>	
		<i>Nine Months Ended</i>	
		<i>September 30,</i>	
		<i>2005</i>	<i>2004</i>
Condensed Statements of Operations			
Revenues:			
Operating revenues	\$	1,390,000	\$ 1,262,000
Total revenues		1,390,000	1,262,000
Expenses:			
Cost of goods sold		251,000	267,000
Selling, general and administrative - affiliates		1,158,000	938,000
Selling, general and administrative		580,000	667,000
Depreciation		89,000	90,000
Total expenses		2,078,000	1,962,000
Net loss	\$	<u>(688,000)</u>	\$ <u>(700,000)</u>

Note 15 - Income Taxes

We recognize deferred tax assets and liabilities for the expected future tax consequence of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the Fund's book and tax bases of assets and liabilities and tax carry forwards using enacted tax rates in effect for the year in which the differences are expected to reverse. The principal tax carry forwards and temporary differences giving rise to our deferred taxes consist of tax net operating loss carry forwards, valuation allowances and differences in inventory basis for book and tax.

A valuation allowance is provided when the probability that the deferred tax asset to be realized does not meet the criteria established by the Financial Accounting Standards Board. The Fund has determined, based on its history of operating losses and its expectations for the future, that it is more likely than not that the net deferred tax assets on September 30, 2005 and December 31, 2004, will not be realized and have provided a valuation allowance for the net deferred tax assets. No provision for income was made during 2005 due to our net operating loss carry forwards and unrealized temporary book-tax differences. We have a federal net operating loss carryforward of approximately \$26,128,000 expiring during various years beginning in 2012 and ending in 2024. We also have approximately \$4,400,000 of inventory in excess of our book balance for tax purposes, which is considered a temporary difference.

Note 16 - Commitments and Contingencies

We, as an owner of real estate, are subject to various environmental laws of federal, state and local governments. Compliance by us with existing laws has not had a material adverse effect on our financial condition and results of operations. However, we cannot predict the impact of new or changed laws or regulations on our current properties or on properties that it may acquire in the future.

We do not believe there is any litigation threatened against us other than routine litigation arising out of the ordinary course of business, some of which is expected to be covered by insurance and none of which is expected to have a material adverse effect on our consolidated financial statements. We believe we have adequate insurance.

NTS/LFII and NTS/VA have various certificates of deposit, bonds and letters of credits outstanding to governmental agencies and utility companies. NTS/VA had outstanding letters of credit totaling approximately \$50,000 at September 30, 2005. The primary purpose of these documents is to ensure that the work at the developments is completed in accordance with the construction plans as approved by the appropriate governmental agency or utility company.

It is estimated that the homeowners' association amenities at the Fawn Lake project will be substantially completed by December 2009. Based on engineering studies and projections, NTS/VA will incur additional costs, excluding interest, of approximately \$3,810,000 to complete the homeowners' association amenities for the project. These costs are estimated to be incurred as follows: \$2,101,000 for 2005, \$1,346,000 for 2006, \$211,000 for 2007, \$81,000 for 2008 and \$71,000 for 2009.

Note 17 - Guaranties to the Fund

NTS Guaranty Corporation (the "Guarantor"), an affiliate of the Sponsor, has guaranteed that, at the time that we are liquidated and dissolved, the total distributions we have made to shareholders from all sources during our existence is at least equal to the original capital contributions attributable to our then outstanding shares. As of September 30, 2005, the original capital contributions attributable to our outstanding shares were \$63,690,000, and we had paid distributions of approximately \$23,141,000.

Any liability of the Guarantor under the guaranty is expressly limited to its assets. The Guarantor holds a \$10 million demand note receivable from Mr. J.D. Nichols, Chairman of the Board of Directors of the Sponsor. There can be no assurance that Mr. Nichols will, if called upon, be able to honor his obligation to the Guarantor or that the Guarantor will be able to satisfy its obligation under the guaranty. The Guarantor may in the future guarantee obligations of other third parties including guaranties of obligations owed by our affiliates to other entities.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Consolidated Financial Statements in Item 1 and the cautionary statements below.

Critical Accounting Policies

The accompanying consolidated financial statements were prepared in conformity with U.S. generally accepted accounting principles. Application of these accounting principles requires us to make estimates about the future resolution of existing uncertainties; as a result, actual results could differ from these estimates. In preparing these financial statements, we have made our best estimates and judgments of the amounts and disclosures included in the financial statements, giving due regard to materiality.

Revenue Recognition

We recognize revenue and related costs from lot sales using the accrual method in accordance with U.S. generally accepted accounting principles, which is when payment has been received and title, possession and other attributes of ownership have been transferred to the buyer, and we are not obligated to perform significant activities after the sale. The country club recognizes operating revenue as services are performed.

Inventory

Inventory is stated at the lower of cost or net realizable value. Inventory includes all direct costs of land, land development, and amenities, including interest, real estate taxes, and certain other costs incurred during the development period including marketing costs of initial membership sales of the Lake Forest Country Club, less amounts charged to cost of sales. Inventory costs are allocated to individual lots sold using their relative sales values. The use of the relative sales value method to record cost of sales requires the use of estimates of sales values, development costs (net of country club initiation fees) and absorption periods over the life of the project. Given the long-term nature of the projects and inherent economic volatility of residential real estate and the use of estimates to determine sales values, development costs and absorption periods, it is reasonably possible that such estimates could change in the near term. Any changes in estimates are accounted for prospectively over the life of the project.

Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," specifies circumstances in which certain long-lived assets must be reviewed for impairment. If the carrying amount of an asset exceeds the sum of its expected future cash flows, the asset's carrying value must be written down to fair value. There were no impairment losses during any of the periods presented.

During April 2001, the Fawn Lake Country Club was substantially completed. As a result of our intention to sell the Club as a single asset, Statement of Financial Accounting Standards ("SFAS") No. 67, "Accounting for Costs and Initial Rental Operations of Real Estate Projects," requires that the Club be reported separately from inventory on our balance sheets within property and equipment. The assets' estimated fair market value was determined to be approximately \$3,000,000 and is included in property and equipment on the September 30, 2005 and December 31, 2004, balance sheets as an asset held for use pursuant to SFAS No. 144 and is being depreciated according to our normal depreciation policy.

Joint Venture Investment

Our consolidated financial statements include the assets, liabilities, revenues and expenses of our wholly-owned subsidiaries. Investments of 50% or less in affiliated companies are accounted for under the equity method. All significant intercompany transactions and balances have been eliminated.

Cost of Sales

We calculate our costs of sales using a percentage based on estimates of total sales and project costs, principally acquisition and development costs. We estimate cost of sales percentages at the end of each fiscal year, and the resulting cost of sales percentages are applied prospectively. Total estimates are based on an analysis of actual costs incurred to date and the estimated costs of completion. Adjustments to estimated total project sales and development costs for the project affect the cost of goods sold percentage. The difference in the cost of sales percentage of NTS/LFII compared to NTS/VA and the difference in the lot sales mix will create a proportionate change in the combined gross profit margin throughout a given year. Costs of sales for a specific period also include direct selling costs, such as those relating to sales concessions, incurred during the period. These costs are not included in the estimated cost of sales percentage.

Income Tax

No benefit for income taxes was provided during 2004 as we had recorded a valuation allowance equal to the amount of the recorded benefit. No provision for income taxes was made during 2005 due to our net operating loss carry forwards and unrealized temporary book-tax differences. We have determined that it is more likely than not that the net deferred tax asset will not be realized based upon the guidance in SFAS No. 109. See Note 15 to our Consolidated Financial Statements.

Results of Operations

The following tables include our selected summarized operating data for the three and nine months ended September 30, 2005 and 2004. This data is presented to provide assistance in identifying trends in our operating results and other factors affecting our business. This data should be read in conjunction with our financial statements, including the notes thereto, in Part I, Item 1 of this report.

<i>Three Months Ended September 30, 2005</i>				
	<i>MIF</i>	<i>NTS/LFII</i>	<i>NTS/VA</i>	<i>Total</i>
Lot sales, net of discounts.....	\$ -	\$ 1,984,000	\$ 559,000	\$ 2,543,000
Cost of sales.....	-	(573,000)	(442,000)	(1,015,000)
Country Club income.....	-	-	540,000	540,000
Interest and miscellaneous income	-	6,000	11,000	17,000
Operating expenses	(119,000)	(329,000)	(530,000)	(978,000)
Country Club expenses	-	-	(743,000)	(743,000)
Depreciation and amortization	-	-	(23,000)	(23,000)
Income from investment in unconsolidated affiliate..	82,000	-	-	82,000
Net (loss) income.....	(37,000)	1,088,000	(628,000)	423,000

<i>Three Months Ended September 30, 2004</i>				
	<i>MIF</i>	<i>NTS/LFII</i>	<i>NTS/VA</i>	<i>Total</i>
Lot sales, net of discounts.....	\$ -	\$ 910,000	\$ 2,035,000	\$ 2,945,000
Cost of sales.....	-	(803,000)	(1,596,000)	(2,399,000)
Country Club income.....	-	-	510,000	510,000
Interest and miscellaneous income	-	1,000	10,000	11,000
Operating expenses	(105,000)	(167,000)	(587,000)	(859,000)
Country Club expenses	-	-	(803,000)	(803,000)
Depreciation and amortization	-	-	(27,000)	(27,000)
Loss on investment in unconsolidated affiliate	(12,000)	-	-	(12,000)
Net loss	(117,000)	(59,000)	(458,000)	(634,000)

<i>Nine Months Ended September 30, 2005</i>				
	<i>MIF</i>	<i>NTS/LFII</i>	<i>NTS/VA</i>	<i>Total</i>
Lot sales, net of discounts.....	\$ -	\$ 4,462,000	\$ 9,543,000	\$ 14,005,000
Cost of sales.....	-	(1,288,000)	(7,286,000)	(8,574,000)
Country Club income.....	-	-	1,390,000	1,390,000
Interest and miscellaneous income	7,000	11,000	27,000	45,000
Operating expenses	(394,000)	(714,000)	(2,176,000)	(3,284,000)
Country Club expenses	-	-	(2,078,000)	(2,078,000)
Depreciation and amortization.....	-	-	(73,000)	(73,000)
Income from investment in unconsolidated affiliate..	520,000	-	-	520,000
Net income (loss).....	133,000	2,471,000	(653,000)	1,951,000

<i>Nine Months Ended September 30, 2004</i>				
	<i>MIF</i>	<i>NTS/LFII</i>	<i>NTS/VA</i>	<i>Total</i>
Lot sales, net of discounts.....	\$ -	\$ 3,035,000	\$ 8,712,000	\$ 11,747,000
Cost of sales.....	-	(2,674,000)	(6,923,000)	(9,597,000)
Country Club income.....	-	-	1,262,000	1,262,000
Interest and miscellaneous income	3,000	1,000	54,000	58,000
Operating expenses	(333,000)	(577,000)	(1,918,000)	(2,828,000)
Country Club expenses	-	-	(1,962,000)	(1,962,000)
Depreciation and amortization.....	-	-	(86,000)	(86,000)
Income from investment in unconsolidated affiliate..	258,000	-	-	258,000
Net loss	(72,000)	(215,000)	(861,000)	(1,148,000)

The following discussion relating to changes in our results of operations includes only material line items within our Statements of Operations and line items for which there was a material change between the three and nine months ending September 30, 2005 and 2004.

Revenues

Revenue from lot sales decreased to \$2,543,000 in the three months ended September 30, 2005, from \$2,945,000 in the comparable period in 2004. The decrease of \$402,000, or 14%, was the result of our selling 12 lots in the three months ending September 30, 2005, as compared with 24 lots in the comparable period in 2004. The average sales price increased to \$212,000 in the three months ended September 30, 2005 from \$123,000 in the comparable period in 2004, due to six lakeside lots being sold for an average of \$286,000 each in 2005.

Revenue from lot sales increased to \$14,005,000 in the nine months ended September 30, 2005, from \$11,747,000 in the comparable period in 2004. The increase of \$2,258,000, or 19%, was the result of our average sales price increasing to \$184,000 in the nine months ended September 30, 2005 from \$142,000 due to three lots being sold for approximately \$599,000 each and one lot being sold for \$629,000 in the comparable period in 2005. We sold 76 lots in the nine months ending September 30, 2005, as compared with 83 lots in the comparable period in 2004.

Cost of Sales

Cost of sales decreased to \$1,015,000 in the three months ended September 30, 2005, from \$2,399,000 in the comparable period in 2004. The decrease of \$1,384,000, or 58%, was due to the decrease in sales in 2005 compared to 2004 and the decrease in the cost of sales percentage for NTS/LFII in 2005 compared to 2004.

Cost of sales decreased to \$8,574,000 in the nine months ended September 30, 2005, from \$9,597,000 in the comparable period in 2004. The decrease of \$1,023,000, or 11%, was due to the decrease in the cost of sales percentage for NTS/LFII in 2005 compared to 2004.

Presented below are the gross profit margins for the three and nine months ended September 30, 2005 and 2004:

	<i>Three Months Ended September 30,</i>		<i>Nine Months Ended September 30,</i>	
	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
NTS/LFII	71%	12%	71%	12%
NTS/VA	21%	22%	24%	21%
Combined gross profit margins	60%	19%	39%	18%

The increase in gross margin percentages at NTS/VA for the nine months ended September 30, 2005 as compared with the comparable periods in 2004 is due to revised estimates of the ultimate sales values, development costs and absorption periods. The decrease in gross margin percentage at NTS/VA for the three months ended September 30, 2005 as compared with 2004, is primarily due to increased direct costs of sales specifically identifiable to lots sold to individual purchasers. As a result of the inherent economic volatility of residential real estate, we cannot be certain that the current estimated gross profit percentages will not be revised in the future.

NTS/LFII's increased profit margin in 2005 is a result of the near term completion of this development. With fewer than 25 lots remaining to be developed, our expected development costs have become more predictable with fewer anticipated contingencies. One remaining tract of land is expected to be sold as a parcel for a 48 home unit project.

We periodically review the value of land and inventories and determine whether any impairment charges are needed to reflect declines in value. We did not record any impairment charges during the periods ended September 30, 2005 and 2004. The estimated net realizable value of real estate inventories represents our best estimate based on present plans and intentions, selling prices in the ordinary course of business and anticipated economic and market conditions. Accordingly, the realization of the value of our real estate inventories is dependent on future events and conditions that may cause actual results to differ from amounts presently estimated.

The income and expenses of the Fawn Lake Country Club have been included in our statements of operations. It is our intention to sell the Club as a single asset.

Presented below are the approximate condensed statements of operations for the Fawn Lake Country Club for the three and nine months ended September 30, 2005 and 2004:

	<i>(Unaudited)</i>	
	<i>Three Months Ended September 30,</i>	
	<i>2005</i>	<i>2004</i>
Condensed Statements of Operations		
Revenues:		
Operating revenues	\$ 540,000	\$ 510,000
Total revenues	540,000	510,000
Expenses:		
Cost of goods sold	105,000	106,000
Selling, general and administrative - affiliates	399,000	376,000
Selling, general and administrative	205,000	288,000
Depreciation	34,000	33,000
Total expenses	743,000	803,000
Net loss	\$ (203,000)	\$ (293,000)

		<i>Nine Months Ended September 30,</i>	
		<i>2005</i>	<i>2004</i>
Condensed Statements of Operations			
Revenues:			
Operating revenues	\$	1,390,000	\$ 1,262,000
Total revenues		1,390,000	1,262,000
Expenses:			
Cost of goods sold		251,000	267,000
Selling, general and administrative - affiliates		1,158,000	938,000
Selling, general and administrative		580,000	667,000
Depreciation		89,000	90,000
Total expenses		2,078,000	1,962,000
Net loss	\$	<u>(688,000)</u>	\$ <u>(700,000)</u>

Expenses

Selling, general and administrative expenses – affiliates are for actual personnel, marketing and administrative costs as they relate to us, NTS/LFII and NTS/VA which were accrued to NTS Residential Management Company and Residential Management Company (“NTS Management”). In addition, NTS Management is entitled to an overhead recovery, which is a reimbursement for overhead expenses attributable to the employees and the efforts of the NTS Management under the Management Agreements, in an amount equal to 3.75% of the projects’ gross cash receipts, as defined in the Management Agreements.

Selling, general and administrative expenses include directors’ fees, legal, outside accounting, other investor-related expenses and repairs and maintenance costs. Selling, general and administrative expenses also include those costs incurred for marketing related activities.

Selling, general and administrative - affiliates expenses were approximately \$525,000 and \$395,000, respectively, for the three months ended September 30, 2005 and 2004. The increase of \$130,000, or 33%, was primarily a result of the increase of approximately \$96,000 in sales salaries and commissions and approximately \$8,000 in taxes and benefits due to more lot sales to individuals and an increase in legal salaries and finance salaries of approximately \$15,000 and \$10,000, respectively, due to the reallocation of employee’s salaries, as compared to the same period in 2005.

Selling, general and administrative - affiliates expenses were approximately \$1,818,000 and \$1,497,000, respectively, for the nine months ended September 30, 2005 and 2004. The increase of \$321,000, or 21%, was primarily a result of the increase of approximately \$123,000 in commissions due to more lot sales to individuals, an increase in the overhead recovery fee on cash receipts of approximately \$84,000 and increases in legal salaries and finance salaries of approximately \$45,000 and \$32,000, respectively, due to the reallocation of employee’s salaries, as compared to the same period in 2005. The increase in the overhead recovery fee is a direct result of the cash receipts from increased lot sales, as compared to the same period in 2004.

Selling, general and administrative expenses were approximately \$432,000 and \$430,000, respectively, for the three months ended September 30, 2005 and 2004. The increase of \$2,000, or 0.5%, was primarily a result of an increase in legal and professional fees of approximately \$27,000 and increases in other operating expenses offset by a decrease in advertising of approximately \$46,000 for the three months ended September 30, 2005, as compared to the same period in 2004.

Selling, general and administrative expenses were approximately \$1,392,000 and \$1,260,000, respectively, for the nine months ended September 30, 2005 and 2004. The increase of \$132,000, or 10%, was primarily a result of an increase in advertising and marketing of approximately \$20,000, an increase in insurance expense of approximately \$40,000 and an increase in professional fees of approximately \$71,000 for the nine months ended September 30, 2005, as compared to the same period in 2004.

Increases and decreases in interest expense generally correspond directly to increases and decreases in the outstanding balances of our borrowings and our subsidiaries borrowings as well as in the capitalization percentage. For the nine months ended September 30, 2005 and 2004, approximately \$76,000 and \$313,000, respectively, was capitalized in inventory. The decrease in total interest is primarily due to the decrease in outstanding balances of loans.

No benefit for income taxes was provided during the three and nine months ended September 30, 2004, as we have recorded a valuation allowance equal to the amount of the recorded benefit. No provision for income taxes was made during 2005 due to our net operating loss carry forwards and unrealized temporary book-tax differences. We have determined that it is more likely than not that the net deferred tax asset will not be realized.

Liquidity and Capital Resources

The primary sources of our liquidity are the ability of our subsidiaries, NTS/LFIL, NTS/VA and us, to continue to defer payment of amounts owed to NTS Development Company and NTS Residential Management Company, to draw upon our mortgage loan and the net proceeds retained from sales of residential lots and homes owned by our subsidiaries and the Joint Venture.

Under the terms of our mortgage loan, we may draw up to \$4,700,000 for certain development costs in accordance with the provisions of the loan agreement. The available balance is not immediately drawable except for the items included in the loan agreement. As of September 30, 2005, the loan balance was \$0. Failure to generate sufficient proceeds from lot sales or the lack of further availability under the development loan may have a material adverse effect on our liquidity and capital resources.

The following table summarizes our sources/uses of cash flow for the nine months ended September 30, 2005 and 2004, respectively:

	<i>Nine Months Ended September 30,</i>	
	<i>2005</i>	<i>2004</i>
Operating activities.....	\$ 5,823,935	\$ 2,942,213
Investing activities.....	(63,951)	(157,630)
Financing activities.....	(5,580,142)	(2,731,711)
Net increase in cash and equivalents	\$ 179,842	\$ 52,872

Cash Flow from Operating Activities

Cash provided by operating activities was approximately \$5,824,000 for the nine months ended September 30, 2005. The primary components of the cash provided by operating activities were net income of approximately \$1,951,000, an increase in accounts payable of approximately \$800,000, an increase in lot deposits of approximately \$280,000, a decrease in inventory of approximately \$3,305,000 and an increase in income from investment in an unconsolidated affiliate of approximately \$520,000. The decrease in inventory was due to the liquidation of inventory by lot sales.

Cash provided by operating activities was approximately \$2,942,000 for the nine months ended September 30, 2004. The primary components of the cash provided by operating activities were a decrease in inventory of approximately \$4,594,000, a decrease in accounts payable of approximately \$678,000 and a net loss of approximately \$1,148,000. The decrease in inventory is due to the liquidation of inventory by lot sales.

Cash Flow from Investing Activities

Cash used in investing activities was approximately \$64,000 for the nine months ended September 30, 2005. The components of the use of cash for investing activities were capital additions at the NTS/VA project of approximately \$9,000 for computers and furniture and approximately \$55,000 for golf operations.

Cash used in investing activities was approximately \$158,000 for the nine months ended September 30, 2004. The component of the use of cash for investing activities was capital additions primarily at NTS/VA golf operations.

Cash Flow from Financing Activities

Cash used in financing activities was approximately \$5,580,000 for the nine months ended September 30, 2005. The primary component of the cash used in financing activities was net payments related to the notes payable of approximately \$1,429,000 and the payments related to accounts payable - affiliates of approximately \$4,151,000, which was owed to NTS Development and NTS Residential Management Company for salary and overhead reimbursements.

Cash used in financing activities was approximately \$2,732,000 for the nine months ended September 30, 2004. The primary component of the cash used in financing activities was net payments related to the development loans for NTS/LFII and NTS/VA projects of approximately \$4,446,000, which was partially offset by the continued deferral of accounts payable to affiliates of approximately \$1,714,000 which is owed to NTS Development and NTS Residential Management Company for salary and overhead reimbursements.

Future Liquidity

We intend to satisfy our future liquidity needs through cash provided by operations, cash reserves, additional borrowings secured by our properties and deferrals of amounts owed to NTS Development and NTS Management. There can be no assurance that funds from operations, reserves or borrowings will be available, or that NTS Development and NTS Management will continue to defer amounts due them past March 31, 2006. If these sources of liquidity are not available our Advisor will manage the demand on liquidity according to our best interest.

In the next twelve months, we expect to use approximately \$8,000,000 to \$11,000,000 of our cash for development costs. We expect future lot sales and borrowings secured by our properties to be the source of this cash. The projected development costs assume demand for lots to continue at the current rate and that weather patterns are near normal for the following twelve months.

Dissolution and Liquidation

We are a finite life entity. Our organizational documents require us to commence an orderly liquidation by December 31, 2008. Delaware law, our state of incorporation, provides us with a three-year period after the initiation of our liquidation to wind up our affairs and issue final distributions to shareholders. We anticipate initiating our liquidation on or before December 31, 2008.

NTS Guaranty Corporation (the "Guarantor"), an affiliate of the Sponsor, has guaranteed that, at the time that we complete our liquidation and dissolve, the total distributions we have made to shareholders from all sources during our existence will be at least equal to the original capital contributions attributable to our then outstanding shares. As of December 31, 2004, the date of our most recent analysis of the status of our properties, the original capital contributions attributable to our outstanding shares were \$63,690,000, and we had paid distributions of approximately \$23,141,000.

In connection with our ongoing review of the status of our properties and progress to liquidation, we have completed our most recent analysis as of December 31, 2004 as to the approximate total distributions which we anticipate making to our shareholders through dissolution. As final liquidating distributions are not likely for several years, these estimates may change significantly prior to dissolution.

The final liquidating distributions will be made after payment of all of our debts and obligations, including \$8,936,218 currently owed to Affiliates of the Sponsor by us, our portion of the \$656 (as of September 30, 2005 our portion is approximately \$328) currently deferred and owed to Affiliates of the Sponsor by the Orlando Lake Forest Joint Venture. Based upon our most recent analysis referred to above, we currently do not anticipate that the ultimate proceeds from future asset sales and final liquidation will be sufficient to return to shareholders an amount equal to original capital contributions attributable to then outstanding shares. Thus, we anticipate the guaranty to be called upon in order to return original capital contributions attributable to the then outstanding shares.

Any liability of the Guarantor under the guaranty is expressly limited to its assets. The Guarantor holds a \$10 million demand note receivable from Mr. J.D. Nichols, Chairman of the Board of Directors of the Sponsor. There can be no assurance that Mr. Nichols will, if called upon, be able to honor his obligation to the Guarantor or that the Guarantor will be able to satisfy its obligation under the guaranty. The Guarantor may in the future guarantee obligations of other third parties, including guaranties of obligations owed by our affiliates to other entities. Based on our most recent analysis referred to above which includes \$10,000,000 to be provided for by the Guarantor, the remaining amount projected to be distributed to shareholders appears to be sufficient to meet the return of capital guaranty to shareholders. The amount available for distribution to our shareholders, however, cannot be estimated with any certainty given that final distributions are not likely for several years. This estimate may change significantly prior to dissolution.

Website Information

Our website address is www.ntsdevelopment.com. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) of the Securities Exchange Act are available and may be accessed free of charge through the "About NTS" section of our website as soon as reasonably practicable after we electronically file this material with, or furnish it to, the SEC. Our website and the information contained therein or connected thereto are not incorporated into this Quarterly Report on Form 10-Q.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our primary market risk exposure with regard to financial instruments stems from changes in interest rates. The Fund's debt instruments bear interest at both variable and fixed rates as discussed in Note 11 of the Fund's financial statements. For the nine months ended September 30, 2005, a hypothetical 100 basis point increase in interest rates would result in an approximate \$7,000 increase in interest expense. During the nine months ended September 30, 2005, the majority of interest expense incurred was capitalized in inventory.

ITEM 4 - CONTROLS AND PROCEDURES

The President of the NTS Mortgage Income Fund and the Chief Financial Officer of NTS Development Company* (the equivalent of the Chief Financial Officer of the Company) have evaluated our disclosure controls and procedures as of September 30, 2005. Based on that evaluation, the President of the NTS Mortgage Income Fund and the Chief Financial Officer of NTS Development Company concluded that our disclosure controls and procedures were effective as of September 30, 2005. There were no material changes in our internal controls over financial reporting during the third quarter of 2005.

* NTS Development Company provides services to the Company under property management agreements as described in Part II, Note 13 – Related Party Transactions.

PART II - OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

None.

ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5 - OTHER INFORMATION

Not Applicable.

ITEM 6 - EXHIBITS

<u>Exhibit No.</u>		
3(a)(2)	Restated Certificate of Incorporation	(2)
3(b)	By-Laws	(2)
10	Material contracts - the agreements whereby the Registrant acquired all of the issued and outstanding common capital stock of NTS/LFII and NTS/VA, and the Property Management Agreements between the Registrant and NTS Management	(3)
10(b)	Form of Guaranty Agreement	(2)
10(c)	Form of Advisory Agreement	(2)
14	Code of Ethics	(4)
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended	(1)
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended	(1)
32.1	Certification of Chief Executive Officer Pursuant to U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	(1)
32.2	Certification of Chief Financial Officer Pursuant to U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	(1)
<hr/>		
(1)	Filed as part of this quarterly report on Form 10-Q.	
(2)	Incorporated by reference from the Registrant's Registration Statement on Form S-11, referencing the exhibit number used in such Registration Statement.	
(3)	Incorporated by reference from the Registrant's Form 8-K, as filed by the Registrant with the Securities and Exchange Commission on January 14, 1998.	
(4)	Located on the Registrant's website www.ntsdevco.com .	

SIGNATURES

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

NTS MORTGAGE INCOME FUND

By: /s/ Brian F. Lavin
Brian F. Lavin
President of NTS Mortgage Income Fund

Date: November 10, 2005

CERTIFICATION

I, Brian F. Lavin, certify that:

1. I have reviewed this quarterly report on Form 10-Q of NTS Mortgage Income Fund;
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)) 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) 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
 - c) 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 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 board of directors of the registrant:
 - 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 controls over financial reporting.

Date: November 10, 2005

/s/ Brian F. Lavin

Brian F. Lavin

President of NTS Mortgage Income Fund

CERTIFICATION

I, Gregory A. Wells, certify that:

1. I have reviewed this quarterly report on Form 10-Q of NTS Mortgage Income Fund;
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)) 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) 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
 - c) 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 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 board of directors of the registrant:
 - 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 controls over financial reporting.

Date: November 10, 2005

/s/ Gregory A. Wells

Gregory A. Wells

Chief Financial Officer of NTS Development Company,
equivalent of the Chief Financial Officer of the Company

CERTIFICATION

I, Brian F. Lavin, President of NTS Mortgage Income Fund (the “Company”), certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that:

1. The quarterly report on Form 10-Q of the Company for the period ended September 30, 2005 (the “Report”) fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 10, 2005

/s/ Brian F. Lavin

Brian F. Lavin

President of NTS Mortgage Income Fund

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATION

I, Gregory A. Wells, Chief Financial Officer of NTS Development Company, equivalent of the Chief Financial Officer of NTS Mortgage Income Fund (the "Company"), certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that:

1. The quarterly report on Form 10-Q of the Company for the period ended September 30, 2005 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 10, 2005

/s/ Gregory A. Wells

Gregory A. Wells

Chief Financial Officer of NTS Development Company,
equivalent of the Chief Financial Officer of the Company

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.