

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORP /DC/  
Form 10-Q  
April 16, 2012

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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 February 29, 2012

OR

- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the Transition Period From      To

Commission File Number 1-7102

NATIONAL RURAL UTILITIES COOPERATIVE  
FINANCE CORPORATION

(Exact name of registrant as specified in its charter)

DISTRICT OF COLUMBIA  
(State or other jurisdiction of incorporation or organization)

52-0891669  
(I.R.S. Employer Identification Number)

20701 COOPERATIVE WAY, DULLES, VA 20166  
(Address of principal executive offices)  
(Registrant's telephone number, including area code, is 703-467-1800)

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 the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting

company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer “  
company “

Accelerated filer “

Non-accelerated filer x

Smaller reporting

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  
“ No x

The Registrant is a tax-exempt cooperative and consequently is unable to issue any equity capital stock.

## PART 1. FINANCIAL INFORMATION

## Item 1. Financial Statements.

## NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS  
(UNAUDITED)  
(in thousands)

## A S S E T S

|  | February 29,<br>2012 | May 31,<br>2011 |
|--|----------------------|-----------------|
| Cash and cash equivalents              | \$ 381,394           | \$ 293,615      |
| Restricted cash                        | 1,083,466            | 7,690           |
| Investments in equity securities       | 58,721               | 58,601          |
| Loans to members                       | 18,618,738           | 19,330,797      |
| Less: Allowance for loan losses        | (149,474)            | (161,177)       |
| Loans to members, net                  | 18,469,264           | 19,169,620      |
| Accrued interest and other receivables | 202,462              | 201,122         |
| Fixed assets, net                      | 100,430              | 88,794          |
| Debt service reserve funds             | 39,803               | 45,662          |
| Debt issuance costs, net               | 43,251               | 41,714          |
| Foreclosed assets, net                 | 223,183              | 280,811         |
| Derivative assets                      | 301,629              | 343,760         |
| Other assets                           | 28,775               | 30,233          |
|  | \$ 20,932,378        | \$20,561,622    |

See accompanying notes.



## NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

## CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(in thousands)

## LIABILITIES AND EQUITY

|  | February 29,<br>2012 | May 31,<br>2011 |
|--|----------------------|-----------------|
| Short-term debt                              | \$ 5,809,418         | \$ 5,842,924    |
| Accrued interest payable                     | 273,909              | 194,859         |
| Long-term debt                               | 11,714,358           | 11,293,249      |
| Deferred income                              | 19,036               | 17,719          |
| Other liabilities                            | 78,848               | 60,477          |
| Derivative liabilities                       | 620,392              | 477,433         |
| Subordinated deferrable debt                 | 186,440              | 186,440         |
| Members' subordinated certificates:          |                      |                 |
| Membership subordinated certificates         | 646,161              | 646,161         |
| Loan and guarantee subordinated certificates | 696,909              | 756,801         |
| Member capital securities                    | 398,250              | 398,250         |
| Total members' subordinated certificates     | 1,741,320            | 1,801,212       |
| Commitments and contingencies                |                      |                 |
| CFC equity:                                  |                      |                 |
| Retained equity                              | 470,996              | 665,765         |
| Accumulated other comprehensive income       | 9,122                | 9,758           |
| Total CFC equity                             | 480,118              | 675,523         |
| Noncontrolling interest                      | 8,539                | 11,786          |
| Total equity                                 | 488,657              | 687,309         |
|  | \$ 20,932,378        | \$ 20,561,622   |

See accompanying notes.



## NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)  
(in thousands)

|   | For the three months ended |                      | For the nine months ended |                         |
|---|----------------------------|----------------------|---------------------------|-------------------------|
|   | February 29,<br>2012       | February<br>28, 2011 | February 29,<br>2012      | February<br>28,<br>2011 |
| Interest income   | \$ 238,018                 | \$ 254,302           | \$ 723,023                | \$ 755,873              |
| Interest expense  | (190,294)                  | (206,333)            | (587,018)                 | (638,246)               |
| Net interest income   | 47,724                     | 47,969               | 136,005                   | 117,627                 |
| (Provision for) recovery of loan losses                           | (263)                      | 3,374                | 11,862                    | 42,915                  |
| Net interest income after (provision for) recovery of loan losses | 47,461                     | 51,343               | 147,867                   | 160,542                 |
| Non-interest income:  |                            |                      |                           |                         |
| Fee and other income  | 4,716                      | 3,960                | 13,425                    | 19,096                  |
| Derivative (losses) gains   | (25,563)                   | 53,348               | (184,887)                 | 22,405                  |
| Results of operations of foreclosed assets                        | (44,972)                   | (4,854)              | (59,349)                  | (6,323)                 |
| Total non-interest income   | (65,819)                   | 52,454               | (230,811)                 | 35,178                  |
| Non-interest expense:   |                            |                      |                           |                         |
| Salaries and employee benefits                                    | (10,959)                   | (9,700)              | (31,191)                  | (32,420)                |
| Other general and administrative expenses                         | (5,635)                    | (6,370)              | (18,484)                  | (22,224)                |
| (Provision for) recovery of guarantee liability                   | (1,576)                    | (24)                 | (1,504)                   | 358                     |
| Fair value adjustment on foreclosed assets                        | (597)                      | (818)                | (2,686)                   | (2,673)                 |
| Loss on early extinguishment of debt                              | -                          | -                    | (15,525)                  | (3,928)                 |
| Other   | (176)                      | (644)                | (991)                     | (871)                   |
| Total non-interest expense  | (18,943)                   | (17,556)             | (70,381)                  | (61,758)                |
| (Loss) income prior to income taxes                               | (37,301)                   | 86,241               | (153,325)                 | 133,962                 |
| Income tax benefit (expense)                                      | 2                          | (2,589)              | 2,110                     | (1,983)                 |

|   |             |             |              |             |
|---|-------------|-------------|--------------|-------------|
| Net (loss) income   | (37,299)    | 83,652      | (151,215)    | 131,979     |
| Less: Net loss (income) attributable to the noncontrolling interest | 56          | )<br>(4,315 | 3,179        | )<br>(2,391 |
| Net (loss) income attributable to CFC                               | \$ (37,243) | \$ 79,337   | \$ (148,036) | \$ 129,588  |

See accompanying notes.



## NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

## CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(UNAUDITED)

(in thousands)

|                                       | Total      | Noncontrolling<br>interest | Total<br>CFC<br>equity | Accumulated<br>other<br>comprehensive<br>income (loss) | CFC<br>retained<br>equity | Unallocated<br>net<br>loss | Members'<br>capital<br>reserve | Patronage<br>capital<br>allocated | Mem<br>fee<br>edu<br>f |
|---------------------------------------|------------|----------------------------|------------------------|--|---------------------------|----------------------------|--------------------------------|-----------------------------------|------------------------|
| Balance as of<br>May 31, 2011         | \$ 687,309 | \$ 11,786                  | \$ 675,523             | \$ 9,758   | \$ 665,765                | \$ (130,689)               | \$ 272,126                     | \$ 521,897                        | \$                     |
| Patronage<br>capital<br>retirement    | (46,265)   | (44)                       | (46,221)               | -  | (46,221)                  | -                          | -                              | (46,221)                          |                        |
| Net loss                              | (151,215)  | (3,179)                    | (148,036)              | -  | (148,036)                 | (148,036)                  | -                              | -                                 |                        |
| Other<br>comprehensive<br>loss        | (655)      | (19)                       | (636)                  | (636)  | -                         | -                          | -                              | -                                 |                        |
| Total<br>comprehensive<br>loss        | (151,870)  | (3,198)                    | (148,672)              |  |                           |                            |                                |                                   |                        |
| Other                                 | (517)      | (5)                        | (512)                  | -  | (512)                     | -                          | -                              | -                                 |                        |
| Balance as of<br>February 29,<br>2012 | \$ 488,657 | \$ 8,539                   | \$ 480,118             | \$ 9,122   | \$ 470,996                | \$ (278,725)               | \$ 272,126                     | \$ 475,676                        | \$                     |

See accompanying notes.

## NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)  
(in thousands)

|   | For the nine months ended |             |
|---|---------------------------|-------------|
|   | February                  | February    |
|   | 29,                       | 28,         |
|   | 2012                      | 2011        |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |                           |             |
| Net (loss) income   | \$ (151,215)              | \$ 131,979  |
| Adjustments to reconcile net (loss) income to net cash provided by operating activities |                           |             |
| Amortization of deferred income   | (8,026)                   | (6,639)     |
| Amortization of debt issuance costs and deferred charges                                | 8,590                     | 13,181      |
| Depreciation  | 2,982                     | 1,743       |
| Recovery of loan losses   | (11,862)                  | (42,915)    |
| Provision for (recovery of) guarantee liability   | 1,504                     | (358)       |
| Results of operations of foreclosed assets  | 59,349                    | 6,323       |
| Fair value adjustment on foreclosed assets  | 2,686                     | 2,673       |
| Derivative forward value  | 184,604                   | (28,090)    |
| Changes in operating assets and liabilities:  |                           |             |
| Accrued interest and other receivables  | 1,760                     | 9,105       |
| Accrued interest payable  | 79,050                    | 77,905      |
| Other   | 29,509                    | 19,852      |
| Net cash provided by operating activities   | 198,931                   | 184,759     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |                           |             |
| Advances made on loans  | (4,859,321)               | (6,538,373) |
| Principal collected on loans  | 5,457,983                 | 5,624,038   |
| Net investment in fixed assets  | (14,618)                  | (21,146)    |
| Proceeds from foreclosed assets   | 33,387                    | 37,145      |
| Investments in foreclosed assets  | (37,794)                  | (124,558)   |
| Net proceeds from sale of loans   | 112,100                   | 268,363     |
| Investments in equity securities  | -                         | (24)        |
| Change in restricted cash   | (1,075,776)               | 5,703       |

|   |             |             |
|---|-------------|-------------|
| Net cash used in investing activities                         | (384,039)   | (748,852)   |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                   |             |             |
| Proceeds from issuances of short-term debt, net               | 80,123      | 1,379,646   |
| Issuance costs for revolving bank lines of credit             | (3,626)     | -           |
| Proceeds from issuance of long-term debt                      | 1,461,604   | 1,866,479   |
| Payments for retirement of long-term debt                     | (1,169,170) | (2,655,756) |
| Payments for retirement of subordinated deferrable debt       | -           | (125,000)   |
| Proceeds from issuance of members' subordinated certificates  | 28,521      | 60,790      |
| Payments for retirement of members' subordinated certificates | (80,162)    | (27,872)    |
| Payments for retirement of patronage capital                  | (44,403)    | (48,647)    |
| Net cash provided by financing activities                     | 272,887     | 449,640     |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS          | 87,779      | (114,453)   |
| BEGINNING CASH AND CASH EQUIVALENTS                           | 293,615     | 513,906     |
| ENDING CASH AND CASH EQUIVALENTS                              | \$ 381,394  | \$ 399,453  |

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)  
(in thousands)

For the nine months ended  
February                      February 28,  
29,                                      2011  
2012

SUPPLEMENTAL DISCLOSURE OF CASH FLOW  
INFORMATION

|  |            |            |
|--|------------|------------|
| Cash paid for interest   | \$ 499,378 | \$ 547,160 |
| Cash paid for income taxes   | 210        | 1,145      |
| Non-cash financing and investing activities:                                 |            |            |
| Subordinated certificates applied against loan balances                      | \$ 534     | \$ 174     |
| Patronage capital applied against loan balances                              | 134        | 104        |
| Noncontrolling interest patronage capital applied against loan balances      | 44         | -          |
| Fair value of foreclosed assets applied as repayment of loans                | -          | 128,130    |
| Charge-offs of loan balances   | -          | 327,799    |
| Net decrease in debt service reserve funds/debt service reserve certificates | (5,859)    | -          |

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

(1) General Information and Accounting Policies

(a) Basis of Presentation

The accompanying financial statements include the consolidated accounts of National Rural Utilities Cooperative Finance Corporation (“CFC”), Rural Telephone Finance Cooperative (“RTFC”), National Cooperative Services Corporation (“NCSC”) and certain entities created and controlled by CFC to hold foreclosed assets and accommodate loan securitization transactions, after elimination of intercompany accounts and transactions.

Unless stated otherwise, references to “we,” “our” or “us” represent the consolidation of CFC, RTFC, NCSC and certain entities created and controlled by CFC to hold foreclosed assets and accommodate loan securitization transactions. Foreclosed assets are held by two groups of subsidiaries wholly-owned by CFC. Our Denton Realty Partners entities (“DRP”) hold assets, including a land development loan, limited partnership interests in certain real estate developments and developed lots and land and raw land in Texas. Caribbean Asset Holdings LLC (“CAH”) holds our investment in cable and telecommunications operating entities in the United States Virgin Islands (“USVI”), British Virgin Islands and St. Maarten.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States (“GAAP”) requires management to make estimates and assumptions that affect the assets, liabilities, revenue and expenses reported in the financial statements, as well as amounts included in the notes thereto, including discussion and disclosure of contingent liabilities. The accounting estimates that require our most significant and subjective judgments include the allowance for loan losses and the determination of the fair value of our derivatives and certain aspects of our foreclosed assets. While we use our best estimates and judgments based on the known facts at the date of the financial statements, actual results could differ from these estimates as future events occur.

These interim unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended May 31, 2011.

In the opinion of management, the accompanying condensed consolidated financial statements contain all adjustments (which consist only of normal recurring accruals) necessary for a fair presentation of our results of operations and financial position for the interim periods presented.

(b) Variable Interest Entities

We are required to consolidate the financial results of RTFC and NCSC because CFC is the primary beneficiary of variable interests in RTFC and NCSC due to its exposure to absorbing the majority of their expected losses and because CFC manages the business activities of RTFC and NCSC. Under separate guarantee agreements, RTFC and NCSC pay CFC a fee to indemnify against loan losses. CFC manages the business activities of RTFC and NCSC through separate management agreements. Additionally, CFC is the sole lender to RTFC and the primary source of funding to NCSC. NCSC funds its lending programs through loans from CFC and debt guaranteed by CFC.

RTFC and NCSC creditors have no recourse against CFC in the event of a default by RTFC or NCSC, unless there is a guarantee agreement under which CFC has guaranteed NCSC or RTFC debt obligations to a third party. At February

29, 2012, CFC had guaranteed \$115 million of NCSC debt and derivative instruments and confirmed letters of credit with third parties, and CFC's maximum potential exposure for these instruments totaled \$126 million. The maturities for NCSC obligations guaranteed and confirmed by CFC run through 2031. Guarantees of NCSC debt and derivative instruments are not included in Note 9, Guarantees, as the debt and derivatives are reported on the condensed consolidated balance sheet. At February 29, 2012, CFC had confirmed \$1 million of RTFC letters of credit with third parties. The maturities for RTFC obligations confirmed by CFC run through 2013. All CFC loans to RTFC and NCSC are secured by all assets and revenue of RTFC and NCSC. At February 29, 2012, RTFC had total assets of \$714 million including loans outstanding to members of \$580 million, and NCSC had total assets of \$613 million including loans outstanding of \$584 million. At February 29, 2012, CFC had committed to lend RTFC up to \$4,000 million, of which \$569 million was outstanding. At February 29, 2012, CFC had committed to provide up to \$2,000 million of credit to NCSC, of which \$679 million was outstanding, representing \$564 million of outstanding loans and \$115 million of credit enhancements.

## (c) Restricted Cash

Restricted cash represents cash and cash equivalents for which use is contractually restricted. At February 29, 2012, restricted cash included \$1,076 million that was subsequently used for the repayment of \$1,000 million of medium-term notes that matured on March 1, 2012, and the related accrued interest. See Note 13, Subsequent Events.

## (d) Loan Sales

We account for the sale of loans resulting from direct loan sales to third parties and securitization transactions by removing the financial assets from our condensed consolidated balance sheets when control has been surrendered. We recognize related servicing fees on an accrual basis over the period for which servicing activity is provided. Deferred transaction costs and unamortized deferred loan origination costs related to the loans sold are included in the calculation of the gain or loss on the sale. We do not hold any continuing interest in the loans sold to date. We have no obligation to repurchase loans from the purchaser, except in the case of breaches of representations and warranties. We retain the servicing performance obligations on these loans. We have not recorded a servicing asset or liability.

During the nine months ended February 29, 2012 and February 28, 2011, we sold CFC loans with outstanding balances totaling \$112 million and \$268 million, respectively, at par for cash. We recorded a loss on sale of loans, representing the unamortized deferred loan origination costs and transaction costs for the loans sold, which was immaterial during the nine months ended February 29, 2012 and February 28, 2011.

## (e) Interest Income

Interest income on loans is recognized using the effective interest method. The following table presents the components of interest income:

|  | For the three months ended |                         | For the nine months ended |                         |
|--|----------------------------|-------------------------|---------------------------|-------------------------|
|  | February<br>29,<br>2012    | February<br>28,<br>2011 | February<br>29,<br>2012   | February<br>28,<br>2011 |
| (dollar amounts in thousands)                |                            |                         |                           |                         |
| Interest on long-term fixed-rate loans       | \$ 216,948                 | \$ 227,118              | \$ 662,135                | \$ 676,484              |
| Interest on long-term variable-rate<br>loans | 5,197                      | 12,041                  | 18,104                    | 34,642                  |
| Interest on line of credit loans             | 7,243                      | 11,154                  | 23,607                    | 33,477                  |
| Interest on restructured loans               | 5,761                      | 696                     | 10,537                    | 2,096                   |
| Interest on non-performing loans             | -                          | 149                     | -                         | 149                     |
| Interest on investments                      | 1,305                      | 967                     | 3,086                     | 3,001                   |
| Fee income (1)                               | 1,564                      | 2,177                   | 5,554                     | 6,024                   |
| Total interest<br>income                     | \$ 238,018                 | \$ 254,302              | \$ 723,023                | \$ 755,873              |

(1) Primarily related to conversion fees that are deferred and recognized using the effective interest method over the remaining original loan interest rate pricing term, except for a small portion of the total fee charged to cover administrative costs related to the conversion, which is recognized immediately.

Deferred income on the condensed consolidated balance sheets primarily includes deferred conversion fees totaling \$12 million at February 29, 2012 and May 31, 2011.





## (f) Interest Expense

The following table presents the components of interest expense:

| (dollar amounts in thousands)       | For the three months ended |                         | For the nine months ended |                         |
|-------------------------------------|----------------------------|-------------------------|---------------------------|-------------------------|
|                                     | February<br>29,<br>2012    | February<br>28,<br>2011 | February<br>29,<br>2012   | February<br>28,<br>2011 |
| Interest expense on debt (1):       |                            |                         |                           |                         |
| Commercial paper and bank bid notes | \$ 1,298                   | \$ 2,574                | \$ 4,458                  | \$ 6,583                |
| Medium-term notes                   | 44,954                     | 57,290                  | 146,528                   | 181,490                 |
| Collateral trust bonds              | 78,587                     | 75,223                  | 233,205                   | 229,019                 |
| Subordinated deferrable debt        | 2,806                      | 2,806                   | 8,419                     | 10,552                  |
| Subordinated certificates           | 20,052                     | 20,547                  | 58,428                    | 61,071                  |
| Long-term notes payable             | 38,024                     | 42,411                  | 116,922                   | 134,035                 |
| Debt issuance costs (2)             | 2,128                      | 2,604                   | 9,633                     | 7,722                   |
| Fee expense (3)                     | 2,445                      | 2,878                   | 9,425                     | 7,774                   |
| Total interest expense              | \$ 190,294                 | \$ 206,333              | \$ 587,018                | \$ 638,246              |

(1) Represents interest expense and the amortization of discounts on debt.

(2) Includes amortization of all deferred charges related to the issuance of debt, principally underwriters' fees, legal fees, printing costs and comfort letter fees. Amortization is calculated using the effective interest method. Also includes issuance costs related to dealer commercial paper, which are recognized as incurred.

(3) Includes various fees related to funding activities, including fees paid to banks participating in our revolving credit agreements. Fees are recognized as incurred or amortized on a straight-line basis over the life of the respective agreement.

We exclude indirect costs, if any, related to funding activities from interest expense.

## (g) Derivative Financial Instruments

We are an end-user of financial derivative instruments. We use derivatives such as interest rate swaps and treasury locks for forecasted transactions to mitigate interest rate risk. Consistent with the accounting standards for derivative financial instruments, we record derivative instruments on the condensed consolidated balance sheets as either an asset or liability measured at fair value. In recording the fair value of derivative assets and liabilities, we do not net our positions under contracts with individual counterparties. Changes in the fair value of derivative instruments along with realized gains and losses from cash settlements are recognized in the derivative gains (losses) line item of the condensed consolidated statement of operations unless specific hedge accounting criteria are met.

We formally document, designate and assess the effectiveness of transactions that receive hedge accounting treatment. If applicable hedge accounting criteria are satisfied, the change in fair value of derivative instruments is recorded to other comprehensive income, and net cash settlements are recorded in interest expense. The gain or loss on derivatives used as a cash flow hedge of a forecasted debt transaction is recorded as a component of other comprehensive income and amortized as interest expense using the effective interest method over the term of the hedged debt. Any ineffectiveness in the hedging relationship is recognized as cash settlements in the period for which ineffectiveness has been determined in the derivative gains (losses) line item.

A transition adjustment of \$62 million was recorded as an other comprehensive loss on June 1, 2001, the date we implemented the accounting standards for derivative financial instruments. This amount will be amortized into earnings through April 2029 in the derivative gains (losses) line of the statement of operations.

Cash activity associated with interest rate swaps is classified as an operating activity in the condensed consolidated statements of cash flows.

(h) Loss on early extinguishment of debt

We redeem outstanding debt early from time to time to manage liquidity and interest rate risk. When we redeem outstanding debt early, we recognize a gain or loss related to the difference between the amount paid to redeem the debt and the net book value of the extinguished debt as a component of non-interest expense in the gain (loss) on early extinguishment of debt line item.

In August 2011 and October 2011, we redeemed a total of \$500 million of our \$1,500 million, 7.25 percent Series C medium-term notes with an original maturity of March 1, 2012 at a premium. Both the premium and unamortized issuance costs totaling \$16 million were recorded as a loss on extinguishment of debt during the nine months ended February 29, 2012.

## (2) Loans and Commitments

Loans outstanding to members and unadvanced commitments by loan type and by member class are summarized as follows:

| (dollar amounts in thousands)   | February 29, 2012    |                                  | May 31, 2011         |                                  |
|---------------------------------|----------------------|----------------------------------|----------------------|----------------------------------|
|                                 | Loans<br>outstanding | Unadvanced<br>commitments<br>(1) | Loans<br>outstanding | Unadvanced<br>commitments<br>(1) |
| Total by loan type (2):         |                      |                                  |                      |                                  |
| Long-term fixed-rate loans      | \$ 16,590,157        | \$ -                             | \$ 16,404,940        | \$ -                             |
| Long-term variable-rate loans   | 660,713              | 5,430,391                        | 1,278,391            | 5,461,484                        |
| Loans guaranteed by RUS (3)     | 220,257              | -                                | 226,695              | -                                |
| Line of credit loans            | 1,140,097            | 8,706,593                        | 1,414,650            | 8,609,191                        |
| Total loans outstanding         | 18,611,224           | 14,136,984                       | 19,324,676           | 14,070,675                       |
| Deferred origination costs      | 7,514                | -                                | 6,121                | -                                |
| Less: Allowance for loan losses | (149,474)            | -                                | (161,177)            | -                                |
| Net loans outstanding           | \$ 18,469,264        | \$ 14,136,984                    | \$ 19,169,620        | \$ 14,070,675                    |
| Total by member class (2):      |                      |                                  |                      |                                  |
| CFC:                            |                      |                                  |                      |                                  |
| Distribution                    | \$ 13,801,204        | \$ 9,238,487                     | \$ 13,760,228        | \$ 9,369,765                     |
| Power supply                    | 3,572,104            | 3,752,031                        | 4,092,290            | 3,579,437                        |
| Statewide and associate         | 73,381               | 124,479                          | 88,961               | 125,483                          |
| CFC total                       | 17,446,689           | 13,114,997                       | 17,941,479           | 13,074,685                       |
| RTFC                            | 580,205              | 351,205                          | 859,122              | 366,060                          |
| NCSC                            | 584,330              | 670,782                          | 524,075              | 629,930                          |
| Total loans<br>outstanding      | \$ 18,611,224        | \$ 14,136,984                    | \$ 19,324,676        | \$ 14,070,675                    |

(1) The interest rate on unadvanced commitments is not set until drawn, therefore, the long-term unadvanced loan commitments have been classified in this table as variable-rate unadvanced commitments. However, at the time of the advance, the borrower may select a fixed or a variable rate on the new loan.

(2) Includes non-performing and restructured loans.

(3) "RUS" is the Rural Utilities Service.

Non-performing and restructured loans outstanding and unadvanced commitments to members included in the table above are summarized as follows by loan type and by company:

| (dollar amounts in thousands)             | February 29, 2012    |                                  | May 31, 2011         |                                  |
|---|----------------------|----------------------------------|----------------------|----------------------------------|
|   | Loans<br>outstanding | Unadvanced<br>commitments<br>(1) | Loans<br>outstanding | Unadvanced<br>commitments<br>(1) |
| Non-performing and restructured<br>loans: |                      |                                  |                      |                                  |
| Non-performing loans:                     |                      |                                  |                      |                                  |
| CFC:                                      |                      |                                  |                      |                                  |
| Long-term variable-rate loans             | \$ 8,194             | \$ -                             | \$ 8,194             | \$ -                             |
| Line of credit loans (2)                  | 26,652               | 296                              | 23,150               | 2,586                            |

## RTFC:

|                            |           |        |           |          |
|----------------------------|-----------|--------|-----------|----------|
| Long-term fixed-rate loans | 7,090     | -      | -         | -        |
| Total non-performing loans | \$ 41,936 | \$ 296 | \$ 31,344 | \$ 2,586 |

## Restructured loans:

## CFC:

|                                   |            |           |            |           |
|-----------------------------------|------------|-----------|------------|-----------|
| Long-term fixed-rate loans (3)    | \$ 457,838 | \$ -      | \$ 40,413  | \$ -      |
| Long-term variable-rate loans (4) | -          | 45,918    | 433,968    | 91,837    |
| Line of credit loans (4)          | -          | 5,000     | -          | 5,000     |
| Total restructured loans          | \$ 457,838 | \$ 50,918 | \$ 474,381 | \$ 96,837 |

(1) The interest rate on unadvanced commitments is not set until drawn, therefore, the long-term unadvanced loan commitments have been classified in this table as variable-rate unadvanced commitments. However, at the time of the advance, the borrower may select a fixed or a variable rate on the new loan.

(2) The unadvanced commitment is available under a debtor-in-possession facility for which the principal and interest has priority over all other claims.

(3) At February 29, 2012, loans outstanding included \$418 million of restructured loans that were placed on accrual status at a fixed rate on October 1, 2011. While the loans were on non-accrual status, including loans outstanding of \$434 million at May 31, 2011, they were presented as long-term variable-rate loans.

(4) The unadvanced commitment is part of the terms outlined in the related restructure agreement. Loans advanced under these commitments would be classified as performing. Principal and interest due under these performing loans would be in addition to scheduled payments due under the restructured loan agreement.

## Unadvanced Loan Commitments

A total of \$1,267 million and \$999 million of unadvanced commitments at February 29, 2012 and May 31, 2011, respectively, represented unadvanced commitments related to committed lines of credit loans that are not subject to a material adverse change clause at the time of each loan advance. As such, we would be required to advance amounts on these committed facilities as long as the borrower is in compliance with the terms and conditions of the facility. The following table summarizes the available balance under committed lines of credit at February 29, 2012, and the related maturities by fiscal year and thereafter as follows:

| (dollar amounts<br>in thousands) | Available<br>balance | Remaining maturities for the years ended May 31, |            |            |           |            |            |
|----------------------------------|----------------------|--|------------|------------|-----------|------------|------------|
|                                  |                      | 2012   | 2013       | 2014       | 2015      | 2016       | Thereafter |
| Committed lines<br>of credit     | \$1,267,174          | \$ -   | \$ 151,521 | \$ 365,535 | \$ 49,975 | \$ 223,714 | \$ 476,429 |

The remaining unadvanced commitments totaling \$12,870 million and \$13,072 million at February 29, 2012 and May 31, 2011, respectively, were generally subject to material adverse change clauses. Prior to making an advance on these facilities, we confirm that there has been no material adverse change in the business condition, financial or otherwise, of the borrower since the time the loan was approved and confirm that the borrower is currently in compliance with loan terms and conditions.

Unadvanced commitments related to line of credit loans are typically for periods not to exceed five years and are generally revolving facilities used for working capital and backup liquidity purposes. Historically, we have experienced a very low utilization rate on line of credit loan facilities, whether or not there is a material adverse change clause. Since we generally do not charge a fee on the unadvanced portion of the majority of our loan facilities, our borrowers will typically request long-term facilities to cover maintenance and capital expenditure work plans for periods of up to five years and draw down on the facility over that time. In addition, borrowers will typically request an amount in excess of their immediate estimated loan requirements to avoid the expense related to seeking additional loan funding for unexpected items.

The above items all contribute to our expectation that the majority of the unadvanced commitments will expire without being fully drawn upon and that the total unadvanced amount does not necessarily represent future cash funding requirements.

## Payment Status of Loans

The tables below show an analysis of the age of the recorded investment in loans outstanding by member class:

| (dollar amounts in<br>thousands) | February 29, 2012         |                                       |                      |               |                                   |                      |
|----------------------------------|---------------------------|---------------------------------------|----------------------|---------------|-----------------------------------|----------------------|
|                                  | 30-89<br>days past<br>due | 90 days or<br>more<br>past due<br>(1) | Total<br>past<br>due | Current       | Total<br>financing<br>receivables | Non-accrual<br>loans |
| CFC:                             |                           |                                       |                      |               |                                   |                      |
| Distribution                     | \$ -                      | \$ 29,846                             | \$ 29,846            | \$ 13,771,358 | \$ 13,801,204                     | \$ 29,846            |
| Power supply                     | -                         | 5,000                                 | 5,000                | 3,567,104     | 3,572,104                         | 5,000                |
| Statewide and<br>associate       | -                         | -                                     | -                    | 73,381        | 73,381                            | -                    |
| CFC total                        | -                         | 34,846                                | 34,846               | 17,411,843    | 17,446,689                        | 34,846               |
| RTFC                             | -                         | 4,306                                 | 4,306                | 575,899       | 580,205                           | 7,090                |
| NCSC                             | -                         | -                                     | -                    | 584,330       | 584,330                           | -                    |

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|                         |      |           |           |               |               |           |
|-------------------------|------|-----------|-----------|---------------|---------------|-----------|
| Total loans outstanding | \$ - | \$ 39,152 | \$ 39,152 | \$ 18,572,072 | \$ 18,611,224 | \$ 41,936 |
| As a % of total loans   | -%   | 0.21%     | 0.21%     | 99.79%        | 100.00%       | 0.23%     |

(1) All loans 90 days or more past due are on non-accrual status.

May 31, 2011

| (dollar amounts in thousands) | 30-89 days past due | 90 days or more past due (1) | Total past due | Current       | Total financing receivables | Non-accrual loans (2) |
|-------------------------------|---------------------|------------------------------|----------------|---------------|-----------------------------|-----------------------|
| CFC:                          |                     |                              |                |               |                             |                       |
| Distribution                  | \$ 3,745            | \$ 27,599                    | \$ 31,344      | \$ 13,728,884 | \$ 13,760,228               | \$ 465,312            |
| Power supply                  | -                   | -                            | -              | 4,092,290     | 4,092,290                   | -                     |
| Statewide and associate       | -                   | -                            | -              | 88,961        | 88,961                      | -                     |
| CFC total                     | 3,745               | 27,599                       | 31,344         | 17,910,135    | 17,941,479                  | 465,312               |
| RTFC                          | -                   | -                            | -              | 859,122       | 859,122                     | -                     |
| NCSC                          | -                   | -                            | -              | 524,075       | 524,075                     | -                     |
| Total loans outstanding       | \$ 3,745            | \$ 27,599                    | \$ 31,344      | \$ 19,293,332 | \$ 19,324,676               | \$ 465,312            |
| As a % of total loans         | 0.02%               | 0.14%                        | 0.16%          | 99.84%        | 100.00%                     | 2.41%                 |

(1) All loans 90 days or more past due are on non-accrual status.

(2) At May 31, 2011, non-accrual loans included \$434 million of restructured loans that were subsequently placed on accrual status on October 1, 2011.

### Credit Quality

We monitor the credit quality and performance statistics of our financing receivables in an ongoing manner to provide a balance between the credit needs of our members and the requirements for sound credit quality of the loan portfolio. We evaluate the credit quality of our loans using an internal risk rating system that employs similar criteria for all member classes.

Our internal risk rating system is based on a determination of a borrower's risk of default utilizing both quantitative and qualitative measurements.

We have grouped our risk ratings into the categories of pass and criticized based on the criteria below.

- (i) Pass: Borrowers that are not experiencing difficulty and/or showing a potential or well-defined credit weakness.
- (ii) Criticized: Includes borrowers categorized as special mention, substandard and doubtful as described below:
- Special mention: Borrowers that may be characterized by a potential credit weakness or deteriorating financial condition that is not sufficiently serious to warrant a classification of substandard or doubtful.
  - Substandard: Borrowers that display a well-defined credit weakness that may jeopardize the full collection of principal and interest.
  - Doubtful: Borrowers that have a well-defined weakness and the full collection of principal and interest is questionable or improbable.

Each risk rating is reassessed annually based on the receipt of the borrower's audited financial statements; however, interim downgrades and upgrades may take place at any time as significant events or trends occur.

The following table presents our loan portfolio by risk rating category and member class based on available data as of:

| (dollar amounts in thousands) | February 29, 2012 |            |               | May 31, 2011  |            |               |
|-------------------------------|-------------------|------------|---------------|---------------|------------|---------------|
|                               | Pass              | Criticized | Total         | Pass          | Criticized | Total         |
| CFC:                          |                   |            |               |               |            |               |
| Distribution                  | \$ 13,771,358     | \$ 29,846  | \$ 13,801,204 | \$ 13,728,884 | \$ 31,344  | \$ 13,760,228 |
| Power supply                  | 3,567,104         | 5,000      | 3,572,104     | 4,092,290     | -          | 4,092,290     |
| Statewide and associate       | 73,381            | -          | 73,381        | 88,961        | -          | 88,961        |
| CFC total                     | 17,411,843        | 34,846     | 17,446,689    | 17,910,135    | 31,344     | 17,941,479    |
| RTFC                          | 573,115           | 7,090      | 580,205       | 850,817       | 8,305      | 859,122       |
| NCSC                          | 584,330           | -          | 584,330       | 524,075       | -          | 524,075       |
| Total loans outstanding       | \$ 18,569,288     | \$ 41,936  | \$ 18,611,224 | \$ 19,285,027 | \$ 39,649  | \$ 19,324,676 |

### Loan Security

Except when providing line of credit loans, we typically lend to our members on a senior secured basis. Long-term loans are typically secured on a parity with other secured lenders (primarily RUS), if any, by all assets and revenue of the borrower with exceptions typical in utility mortgages. Line of credit loans are generally unsecured. In addition to the lien and security interest we receive under the mortgage, our member borrowers are also required to set rates charged to their customers to achieve certain financial ratios as required by loan covenants.

The following table summarizes our secured and unsecured loans outstanding by loan type and by company:

February 29, 2012

May 31, 2011

(dollar amounts in thousands)

| Total by loan type:           | Secured       | %   | Unsecured    | %  | Secured       | %   | Unsecured    | %   |
|-------------------------------|---------------|-----|--------------|----|---------------|-----|--------------|-----|
| Long-term fixed-rate loans    | \$ 16,019,302 | 97% | \$ 570,855   | 3% | \$ 15,583,068 | 95% | \$ 821,872   | 5%  |
| Long-term variable-rate loans | 585,010       | 89  | 75,703       | 11 | 1,207,580     | 94  | 70,811       | 6   |
| Loans guaranteed by RUS       | 220,257       | 100 | -            | -  | 226,695       | 100 | -            | -   |
| Line of credit loans          | 189,999       | 17  | 950,098      | 83 | 107,193       | 8   | 1,307,457    | 92  |
| Total loans outstanding       | \$ 17,014,568 | 91  | \$ 1,596,656 | 9  | \$ 17,124,536 | 89  | \$ 2,200,140 | 11  |
| Total by company:             |               |     |              |    |               |     |              |     |
| CFC                           | \$ 16,075,136 | 92% | \$ 1,371,553 | 8% | \$ 16,180,454 | 90% | \$ 1,761,025 | 10% |
| RTFC                          | 555,946       | 96  | 24,259       | 4  | 628,020       | 73  | 231,102      | 27  |
| NCSC                          | 383,486       | 66  | 200,844      | 34 | 316,062       | 60  | 208,013      | 40  |
| Total loans outstanding       | \$ 17,014,568 | 91  | \$ 1,596,656 | 9  | \$ 17,124,536 | 89  | \$ 2,200,140 | 11  |



## Loan Loss Allowance

We maintain an allowance for loan losses at a level estimated by management to provide for probable losses inherent in the loan portfolio. Under a guarantee agreement, CFC reimburses RTFC and NCSC for loan losses, therefore, RTFC and NCSC do not maintain separate loan loss allowances.

The activity in the loan loss allowance summarized in the tables below reflects a disaggregation by company of the allowance for loan losses held at CFC:

| (dollar amounts in thousands)              | As of and for the three months ended February 29, 2012 |          |          |            |
|--|--|----------|----------|------------|
|  | CFC  | RTFC (1) | NCSC (1) | Total      |
| Balance as of November 30, 2011            | \$ 130,885   | \$ 9,473 | \$ 8,800 | \$ 149,158 |
| Provision for (recovery of) loan losses    | 1,331  | (914)    | (154)    | 263        |
| Recoveries of loans previously charged-off | 53   | -        | -        | 53         |
| Balance as of February 29, 2012            | \$ 132,269   | \$ 8,559 | \$ 8,646 | \$ 149,474 |

| (dollar amounts in thousands)              | As of and for the three months ended February 28, 2011 |           |          |            |
|--|--|-----------|----------|------------|
|  | CFC  | RTFC (1)  | NCSC (1) | Total      |
| Balance as of November 30, 2010            | \$ 161,030   | \$ 55,215 | \$ 9,301 | \$ 225,546 |
| Recovery of loan losses                    | (1,775)  | (1,502)   | (97)     | (3,374)    |
| Charge-offs                                | -  | -         | (8)      | (8)        |
| Recoveries of loans previously charged-off | 52   | -         | 8        | 60         |
| Balance as of February 28, 2011            | \$ 159,307   | \$ 53,713 | \$ 9,204 | \$ 222,224 |

| (dollar amounts in thousands)              | As of and for the nine months ended February 29, 2012 |          |          |            |
|--|---|----------|----------|------------|
|  | CFC   | RTFC (1) | NCSC (1) | Total      |
| Balance as of May 31, 2011                 | \$ 143,706  | \$ 8,389 | \$ 9,082 | \$ 161,177 |
| (Recovery of) provision for loan losses    | (11,596)  | 170      | (436)    | (11,862)   |
| Recoveries of loans previously charged-off | 159   | -        | -        | 159        |
| Balance as of February 29, 2012            | \$ 132,269  | \$ 8,559 | \$ 8,646 | \$ 149,474 |

| (dollar amounts in thousands)              | As of and for the nine months ended February 28, 2011 |            |          |            |
|--|---|------------|----------|------------|
|  | CFC   | RTFC (1)   | NCSC (1) | Total      |
| Balance as of May 31, 2010                 | \$ 177,655  | \$ 406,214 | \$ 8,895 | \$ 592,764 |
| (Recovery of) provision for loan losses    | (18,506)  | (24,702)   | 293      | (42,915)   |
| Charge-offs                                | -   | (327,799)  | (26)     | (327,825)  |
| Recoveries of loans previously charged-off | 158   | -          | 42       | 200        |
| Balance as of February 28, 2011            | \$ 159,307  | \$ 53,713  | \$ 9,204 | \$ 222,224 |

(1) The allowance for loan losses recorded for RTFC and NCSC are held at CFC with the exception of \$2 thousand of the NCSC loan loss allowance required to cover the exposure for consumer loans at February 28, 2011.

Our allowance for loan losses includes a specific valuation allowance related to individually-evaluated impaired loans, as well as a general reserve for other probable incurred losses for loans that are collectively evaluated. The tables below present the loan loss allowance and the recorded investment in outstanding loans by impairment methodology and by company:

| (dollar amounts in thousands)         | CFC           | February 29, 2012 |            | Total         |
|---------------------------------------|---------------|-------------------|------------|---------------|
|                                       |               | RTFC              | NCSC       |               |
| Ending balance of the allowance:      |               |                   |            |               |
| Collectively evaluated                | \$ 111,524    | \$ 6,606          | \$ 8,646   | \$ 126,776    |
| Individually evaluated                | 20,745        | 1,953             | -          | 22,698        |
| Total ending balance of the allowance | \$ 132,269    | \$ 8,559          | \$ 8,646   | \$ 149,474    |
| Recorded investment in loans:         |               |                   |            |               |
| Collectively evaluated                | \$ 16,954,005 | \$ 573,115        | \$ 584,330 | \$ 18,111,450 |
| Individually evaluated                | 492,684       | 7,090             | -          | 499,774       |
| Total recorded investment in loans    | \$ 17,446,689 | \$ 580,205        | \$ 584,330 | \$ 18,611,224 |
| Loans to members, net (1)             | \$ 17,314,420 | \$ 571,646        | \$ 575,684 | \$ 18,461,750 |

| (dollar amounts in thousands)         | CFC           | May 31, 2011 |            | Total         |
|---------------------------------------|---------------|--------------|------------|---------------|
|                                       |               | RTFC         | NCSC       |               |
| Ending balance of the allowance:      |               |              |            |               |
| Collectively evaluated                | \$ 107,130    | \$ 8,389     | \$ 9,082   | \$ 124,601    |
| Individually evaluated                | 36,576        | -            | -          | 36,576        |
| Total ending balance of the allowance | \$ 143,706    | \$ 8,389     | \$ 9,082   | \$ 161,177    |
| Recorded investment in loans:         |               |              |            |               |
| Collectively evaluated                | \$ 17,435,754 | \$ 859,122   | \$ 524,075 | \$ 18,818,951 |
| Individually evaluated                | 505,725       | -            | -          | 505,725       |
| Total recorded investment in loans    | \$ 17,941,479 | \$ 859,122   | \$ 524,075 | \$ 19,324,676 |

Loans to members, net (1) \$ 17,797,773 \$ 850,733 \$ 514,993 \$ 19,163,499  
(1) Excludes deferred origination costs of \$8 million and \$6 million at February 29, 2012 and May 31, 2011, respectively.

#### Impaired Loans

Our recorded investment in individually-impaired loans and the related specific valuation allowance is summarized below by member class.

| (dollar amounts in thousands)        | February 29, 2012   |                   | May 31, 2011        |                   |
|--------------------------------------|---------------------|-------------------|---------------------|-------------------|
|                                      | Recorded investment | Related allowance | Recorded investment | Related allowance |
| With no specific allowance recorded: |                     |                   |                     |                   |
| CFC/Distribution                     | \$ 457,838          | \$ -              | \$ 40,413           | \$ -              |
| With a specific allowance recorded:  |                     |                   |                     |                   |
| CFC/Distribution                     | 29,846              | 20,494            | 465,312             | 36,576            |
| CFC/Power Supply                     | 5,000               | 251               | -                   | -                 |
| RTFC                                 | 7,090               | 1,953             | -                   | -                 |
| Total                                | 41,936              | 22,698            | 465,312             | 36,576            |
| Total impaired loans                 | \$ 499,774          | \$ 22,698         | \$ 505,725          | \$ 36,576         |

The recorded investment for impaired loans was equal to the total unpaid principal balance for impaired loans as of February 29, 2012 and May 31, 2011.

The table below represents the average recorded investment in impaired loans and the interest income recognized by member class:

| (dollar amounts in thousands) | For the three months ended  |                   |                            |                   |
|-------------------------------|-----------------------------|-------------------|----------------------------|-------------------|
|                               | Average recorded investment |                   | Interest income recognized |                   |
|                               | February 29, 2012           | February 28, 2011 | February 29, 2012          | February 28, 2011 |
|                               |                             |                   |                            |                   |

|                      |            |            |          |        |
|----------------------|------------|------------|----------|--------|
|                      |            |            |          | 2011   |
| CFC/Distribution     | \$ 488,040 | \$ 508,787 | \$ 5,761 | \$ 696 |
| CFC/Power Supply     | 5,000      | -          | -        | -      |
| RTFC                 | 7,130      | 65,920     | -        | -      |
| Total impaired loans | \$ 500,170 | \$ 574,707 | \$ 5,761 | \$ 696 |

For the nine months ended

| (dollar amounts in thousands) | Average recorded investment |              | Interest income recognized |          |
|-------------------------------|-----------------------------|--------------|----------------------------|----------|
|                               | February 29,                | February 28, | February 29,               | February |
|                               | 2012                        | 2011         | 2012                       | 28,      |
|                               |                             |              |                            | 2011     |
| CFC/Distribution              | \$ 492,427                  | \$ 515,354   | \$ 10,537                  | \$ 2,096 |
| CFC/Power Supply              | 2,556                       | -            | -                          | -        |
| RTFC                          | 5,924                       | 275,926      | -                          | -        |
| Total impaired loans          | \$ 500,907                  | \$ 791,280   | \$ 10,537                  | \$ 2,096 |

## Non-performing and Restructured Loans

Interest income was reduced as follows as a result of holding loans on non-accrual status as follows:

| (dollar amounts in thousands) | For the three months ended |                      | For the nine months ended |                         |
|-------------------------------|----------------------------|----------------------|---------------------------|-------------------------|
|                               | February 29,<br>2012       | February 28,<br>2011 | February 29,<br>2012      | February<br>28,<br>2011 |
| Non-performing loans          | \$ 444                     | \$ 319               | \$ 1,249                  | \$ 8,543                |
| Restructured loans            | -                          | 5,508                | 6,714                     | 16,789                  |
| Total                         | \$ 444                     | \$ 5,827             | \$ 7,963                  | \$ 25,332               |

At February 29, 2012 and May 31, 2011, non-performing loans included \$30 million and \$31 million, respectively, of loans to an electric distribution cooperative that undertook a project to develop a geothermal electric generating facility. This borrower filed for bankruptcy in September 2010. The borrower filed a disclosure statement with the bankruptcy court that contained a preliminary draft of a reorganization plan for creditors and other parties of interest to review. The bankruptcy court has set June 29, 2012 as the deadline for the borrower to file a revised draft plan of reorganization, which is expected to be subject to further revisions, hearings and rulings before approval.

At February 29, 2012, non-performing loans also included a total of \$7 million to two telecommunications borrowers and \$5 million to one electric power supply cooperative, for which we do not expect to collect all principal and interest payments as scheduled by the original terms. These non-performing loans were put on non-accrual status during the first quarter of fiscal year 2012 for the telecommunications borrowers and during the second quarter of fiscal year 2012 for the electric borrower.

At February 29, 2012 and May 31, 2011, we had restructured loans totaling \$458 million and \$474 million, respectively, all of which were performing according to their restructured terms. Approximately \$6 million and \$11 million of interest income was accrued on restructured loans during the three and nine months ended February 29, 2012, respectively, compared with \$1 million and \$2 million of interest income in each of the same prior-year periods. At May 31, 2011, we had a \$434 million restructured loan on nonaccrual status to a large electric distribution cooperative. The loan to this borrower has been on non-accrual status since it was restructured in December 2002. Since that time, the borrower made all required payments in accordance with the restructure agreement, all of which have been used to reduce the outstanding principal balance. On October 1, 2011, the loan balance of \$420 million was below the amount of the prepayment option in the restructure agreement, thus there would no longer be a loss recorded if the borrower were to exercise the prepayment option and the loan was placed on accrual status. The accrual rate for the loan of 4.85 percent is based on the effective interest rate returned by the remaining scheduled cash flows through December 2037. At February 29, 2012, all restructured loans were on accrual status with respect to the recognition of interest income.

We believe our loan loss reserve is adequate to cover the losses inherent in our loan portfolio at February 29, 2012.

## Pledging of Loans and Loans on Deposit

We are required to pledge eligible mortgage notes in an amount at least equal to the outstanding balance of our secured debt.

The following table summarizes our loans outstanding as collateral pledged to secure our collateral trust bonds, Clean Renewable Energy Bonds and notes payable to the Federal Agricultural Mortgage Corporation and the amount of the corresponding debt outstanding (see Note 4, Short-Term Debt and Credit Arrangements and Note 5, Long-Term Debt).

| (dollar amounts in thousands)                            | February 29,<br>2012 | May 31,<br>2011 |
|--|----------------------|-----------------|
| Collateral trust bonds:                                  |                      |                 |
| 2007 indenture   |                      |                 |
| Distribution system mortgage notes                       | \$ 5,273,410         | \$ 4,605,921    |
| RUS guaranteed loans qualifying as permitted investments | 171,038              | -               |
| Total pledged collateral                                 | \$ 5,444,448         | \$ 4,605,921    |
| Collateral trust bonds outstanding                       | 4,850,000            | 4,050,000       |
| 1994 indenture   |                      |                 |
| Distribution system mortgage notes                       | \$ 1,653,209         | \$ 1,740,956    |
| Collateral trust bonds outstanding                       | 1,470,000            | 1,475,000       |
| Federal Agricultural Mortgage Corporation:               |                      |                 |
| Distribution and power supply system mortgage notes      | \$ 1,671,603         | \$ 1,786,777    |
| Notes payable outstanding                                | 1,410,800            | 1,410,800       |
| Clean Renewable Energy Bonds Series 2009A:               |                      |                 |
| Distribution and power supply system mortgage notes      | \$ 28,114            | \$ 29,857       |
| Cash   | 7,216                | 7,664           |
| Total pledged collateral                                 | \$ 35,330            | \$ 37,521       |
| Notes payable outstanding                                | 23,487               | 25,294          |

We are required to maintain collateral on deposit in an amount at least equal to the balance of debt outstanding to the Federal Financing Bank of the United States Treasury issued under the Guaranteed Underwriter program of the U.S. Department of Agriculture, which supports the Rural Economic Development Loan and Grant program (see Note 5, Long-Term Debt). The following table shows the collateral on deposit and the amount of the corresponding debt outstanding:

| (dollar amounts in thousands)                                  | February 29,<br>2012 | May 31,<br>2011 |
|--|----------------------|-----------------|
| Federal Financing Bank   |                      |                 |
| Distribution and power supply system mortgage notes on deposit | \$ 3,536,659         | \$ 3,616,040    |
| Notes payable outstanding                                      | 3,150,000            | 3,150,000       |

### (3) Foreclosed Assets

At February 29, 2012 and February 28, 2011, all foreclosed assets were held by DRP and CAH, which are wholly-owned subsidiaries of CFC.

The activity for foreclosed assets is summarized below:

As of and for the nine months ended

| (dollar amounts in thousands) | February 29, 2012 |           |            | February 28, 2011 |           |            |
|-------------------------------|-------------------|-----------|------------|-------------------|-----------|------------|
|                               | CAH               | DRP       | Total      | CAH               | DRP       | Total      |
| Beginning balance             | \$ 246,643        | \$ 34,168 | \$ 280,811 | \$ -              | \$ 42,252 | \$ 42,252  |
| Results of operations         | (59,309)          | (40)      | (59,349)   | (6,314)           | (9)       | (6,323)    |
| Entity value at transfer      | -                 | -         | -          | 216,401           | -         | 216,401    |
| Cash investments (proceeds)   | 13,207            | (8,800)   | 4,407      | 3,140             | (3,998)   | (858)      |
| Fair value adjustment         | -                 | (2,686)   | (2,686)    | -                 | (2,673)   | (2,673)    |
| Ending balance                | \$ 200,541        | \$ 22,642 | \$ 223,183 | \$ 213,227        | \$ 35,572 | \$ 248,799 |

During the quarter ended February 29, 2012, we conducted an assessment of goodwill impairment at CAH due to regional events and market information that became available including the recent closure of a major oil refinery, staff terminations by the local territorial government offices, all resulting in the direct loss of approximately 3,000 jobs, as well as weakening overall economic conditions in the region. In addition, the fiscal year 2012 financial results of CAH's telecommunications and cable television operations were lower than the projected results used to value the operations during fiscal year 2011. Based on these events, we concluded indicators of potential impairment of goodwill and other assets existed. As such, a recoverability analysis was performed on CAH long-lived assets, including definite-lived intangibles assets, in which the sum of undiscounted cash flows associated with these assets were compared to their carrying values. Furthermore, a valuation

analysis was performed on the CAH operating entities to determine the fair value of such entities and compared such fair values were compared to the carrying values to determine if the goodwill balances were impaired.

After taking the above identified items into consideration, management estimated that its forecast of future operating results and cash flows would be lower than previously projected. As a result, we were required to record a goodwill impairment charge of \$36 million and other asset impairment charges in the amount of \$9 million at CAH for the quarter ended February 29, 2012. In addition to these impairment charges, our reported results of operations of foreclosed assets included a net loss of \$14 million for the nine months ended February 29, 2012, related to the operations of our CAH subsidiary. Several factors led to the net loss including, among others, CAH's ability to attract and retain subscribers due to weaker than expected economic conditions which resulted in reductions in revenue; expenses associated with the initiation of modernization efforts related to our network infrastructure and internal systems; and high depreciation expense due to regulatory requirements on the wireline operating entity.

The goodwill and other asset impairment charges are non-cash charges and will not affect our compliance with debt covenants under our existing indentures and credit facility agreements.

#### (4) Short-Term Debt and Credit Arrangements

The following is a summary of short-term debt outstanding:

| (dollar amounts in thousands)                           | February 29,<br>2012 | May 31,<br>2011 |
|---|----------------------|-----------------|
| Short-term debt:  |                      |                 |
| Commercial paper sold through dealers, net of discounts | \$ 1,626,618         | \$ 1,471,715    |
| Commercial paper sold directly to members, at par       | 978,641              | 1,189,770       |
| Commercial paper sold directly to non-members, at par   | 64,236               | 55,160          |
| Total commercial paper                                  | 2,669,495            | 2,716,645       |
| Daily liquidity fund notes sold directly to members     | 435,998              | 308,725         |
| Bank bid notes  | 295,000              | 295,000         |
| Subtotal short-term debt                                | 3,400,493            | 3,320,370       |
| Long-term debt maturing within one year:                |                      |                 |
| Medium-term notes sold through dealers                  | 1,233,877            | 1,986,891       |
| Medium-term notes sold to members                       | 402,875              | 266,067         |
| Secured collateral trust bonds                          | 254,930              | 5,000           |
| Member subordinated certificates                        | 15,090               | 12,440          |
| Secured notes payable                                   | 497,506              | 247,507         |
| Unsecured notes payable                                 | 4,647                | 4,649           |
| Total long-term debt maturing within one year           | 2,408,925            | 2,522,554       |
| Total short-term debt                                   | \$ 5,809,418         | \$ 5,842,924    |

#### Revolving Credit Agreements

At February 29, 2012 and May 31, 2011, we had \$2,845 million and \$3,559 million, respectively, of commitments under revolving credit agreements. We may request letters of credit for up to \$100 million under each agreement in



place at February 29, 2012, which then reduces the amount available under the facility. The following table presents the total available and the outstanding letters of credit under our revolving credit agreements:

| (dollar amounts in thousands) | Total available   |              | Letters of credit outstanding |              | Original maturity | Facility fee per year (1) |
|-------------------------------|-------------------|--------------|-------------------------------|--------------|-------------------|---------------------------|
|                               | February 29, 2012 | May 31, 2011 | February 29, 2012             | May 31, 2011 |                   |                           |
| Three-year agreement          | \$ 1,125,000      | \$ 1,125,000 | \$ -                          | \$ -         | March 21, 2014    | 15 basis points           |
| Four-year agreement           | 877,430           | -            | 7,445                         | -            | October 21, 2015  | 10 basis points           |
| Five-year agreement           | 834,875           | -            | -                             | -            | October 21, 2016  | 10 basis points           |
| Five-year agreement           | -                 | 1,049,000    | -                             | -            | March 16, 2012    | 6 basis points            |
| Three-year agreement          | -                 | 1,370,526    | -                             | 14,474       | March 8, 2013     | 25 basis points           |
| Total                         | \$ 2,837,305      | \$ 3,544,526 | \$ 7,445                      | \$ 14,474    |                   |                           |

(1) Facility fee determined by CFC's senior unsecured credit ratings based on the pricing schedules put in place at the inception of the related agreement.

On October 21, 2011, we terminated and replaced our \$1,049 million five-year and \$1,385 million three-year revolving credit agreements with a new \$885 million four-year credit agreement and \$835 million five-year credit agreement expiring on October 21, 2015 and 2016, respectively. The facility fee and applicable margin are determined by the pricing matrices in the agreements based on our senior unsecured credit ratings. With respect to the borrowings, we have the right to choose between

a (i) Eurodollar rate plus an applicable margin or (ii) base rate calculated based on the greater of prime rate, the federal funds effective rate plus 0.50 percent or the one-month LIBOR rate plus 1 percent, plus an applicable margin. Similar to the previously existing agreements, our ability to borrow or obtain a letter of credit under both agreements is not conditioned on the absence of material adverse changes with regard to CFC. We also have the right, subject to certain terms and conditions, to increase the aggregate amount of the commitments under each of the credit facilities to a maximum of \$1,300 million. The following represents our required and actual financial ratios under the revolving credit agreements:

|  | Requirement | Actual<br>February 29,<br>2012 | May 31,<br>2011 |
|--|-------------|--------------------------------|-----------------|
| Minimum average adjusted TIER over the six most recent fiscal quarters (1) | 1.025       | 1.20                           | 1.19            |
| Minimum adjusted TIER for the most recent fiscal year (1)<br>(2)           | 1.05        | 1.21                           | 1.21            |
| Maximum ratio of adjusted senior debt to total equity (1)                  | 10.00       | 6.35                           | 6.26            |

(1) In addition to the adjustments made to the leverage ratio set forth in the Non-GAAP Financial Measures section, senior debt excludes guarantees to member systems that have certain investment-grade ratings from Moody's Investors Service and Standard & Poor's Corporation. The TIER calculation includes the adjustments set forth in the Non-GAAP Financial Measures section and excludes the results of operations for CAH.

(2) We must meet this requirement to retire patronage capital.

At February 29, 2012 and May 31, 2011, we were in compliance with all covenants and conditions under our revolving credit agreements and there were no borrowings outstanding under these agreements.

#### (5) Long-Term Debt

The following is a summary of long-term debt outstanding:

| (dollar amounts in thousands)          | February 29,<br>2012 | May 31,<br>2011 |
|--|----------------------|-----------------|
| Unsecured long-term debt:              |                      |                 |
| Medium-term notes sold through dealers | \$ 1,429,752         | \$ 1,298,412    |
| Medium-term notes sold to members      | 106,914              | 105,894         |
| Subtotal                               | 1,536,666            | 1,404,306       |
| Unamortized discount                   | (976)                | (990)           |
| Total unsecured medium-term notes      | 1,535,690            | 1,403,316       |
| Unsecured notes payable                | 3,190,982            | 3,194,390       |
| Unamortized discount                   | (1,134)              | (1,279)         |
| Total unsecured notes payable          | 3,189,848            | 3,193,111       |
| Total unsecured long-term debt         | 4,725,538            | 4,596,427       |
| Secured long-term debt:                |                      |                 |
| Collateral trust bonds                 | 6,065,000            | 5,520,000       |

|                                      |               |               |
|--------------------------------------|---------------|---------------|
| Unamortized discount                 | (12,961)      | (11,765)      |
| Total secured collateral trust bonds | 6,052,039     | 5,508,235     |
| Secured notes payable                | 936,781       | 1,188,587     |
| Total secured long-term debt         | 6,988,820     | 6,696,822     |
| Total long-term debt                 | \$ 11,714,358 | \$ 11,293,249 |

In February 2012, we issued \$400 million of 1.00 percent collateral trust bonds due 2015 and \$400 million of 3.05 percent collateral trust bonds due 2022.

At February 29, 2012 and May 31, 2011, we had \$3,150 million of unsecured notes payable outstanding under a bond purchase agreement with the Federal Financing Bank and a bond guarantee agreement with RUS issued under the Guaranteed Underwriter program of the U.S. Department of Agriculture, which supports the Rural Economic Development Loan and Grant program and provides guarantees to the Federal Financing Bank. In the aggregate at February 29, 2012, we had up to \$849 million available under committed loan facilities from the Federal Financing Bank as part of this program. At February 29, 2012 and May 31, 2011, we had up to \$350 million available for advance through October 15, 2013 under a \$500 million committed loan facility from the Federal Financing Bank. In December 2011, we closed an additional \$499 million committed loan facility from the Federal Financing Bank that is available for advance through October 15, 2014 and for which CFC is required to deposit collateral satisfactory to RUS pursuant to the terms of the facility. Advances under both available facilities may have a maturity date of up to 20 years from the date of the advance and the spread we pay over the applicable treasury rate is locked in under this program. Subsequent to February 29, 2012, we borrowed \$169 million under our \$499 million

committed loan facility at a weighted average interest rate of 3.005 percent with a repricing period ranging from 10 to 15 years and a final maturity of 20 years.

At February 29, 2012 and May 31, 2011, we had a total of \$1,411 million of secured notes payable to the Federal Agricultural Mortgage Corporation, of which \$496 million and \$246 million, respectively, is scheduled to mature in the next 12 months and is thus presented as short-term debt. Under the terms of our March 2011 note purchase agreement with the Federal Agricultural Mortgage Corporation, we can borrow up to \$3,900 million at any time from the date of the agreement through January 11, 2016 and thereafter automatically extend the agreement on each anniversary date of the closing for an additional year, unless prior to any such anniversary date, the Federal Agricultural Mortgage Corporation provides CFC with a notice that the draw period will not be extended beyond the then-remaining term. The agreement with the Federal Agricultural Mortgage Corporation is a revolving credit facility that allows us to borrow, repay and re-borrow funds at any time through maturity or from time to time as market conditions permit, provided that the principal amount at any time outstanding under the note purchase agreement is not more than the total available under the agreement.

#### (6) Subordinated Deferrable Debt

The following table is a summary of subordinated deferrable debt outstanding:

| (dollar amounts in thousands) | February 29,<br>2012 | May 31,<br>2011 |
|-------------------------------|----------------------|-----------------|
| NRC 6.10% due 2044            | \$ 88,201            | \$ 88,201       |
| NRU 5.95% due 2045            | 98,239               | 98,239          |
| Total                         | \$ 186,440           | \$ 186,440      |

All subordinated deferrable debt currently outstanding is callable at par at any time.

#### (7) Derivative Financial Instruments

We are an end-user of financial derivative instruments. We utilize derivatives such as interest rate swaps and treasury locks for forecasted transactions to mitigate interest rate risk. The following table shows the notional amounts outstanding for our interest rate swaps by type:

| (dollar amounts in thousands) | February 29,<br>2012 | May 31,<br>2011 |
|-------------------------------|----------------------|-----------------|
| Pay fixed-receive variable    | \$ 5,215,544         | \$ 5,638,123    |
| Pay variable-receive fixed    | 4,651,440            | 5,301,440       |
| Total interest rate swaps     | \$ 9,866,984         | \$ 10,939,563   |

The derivative (losses) gains line item of the condensed consolidated statement of operations includes cash settlements and derivative forward value for derivative instruments that do not meet hedge accounting criteria. Cash settlements includes periodic amounts paid and received related to our interest rate swaps, as well as amounts accrued from the prior settlement date. Derivative forward value includes changes in the fair value of derivative instruments unless specific hedge accounting criteria are met. If applicable hedge accounting criteria are satisfied, the change to the fair value is recorded to other comprehensive income and net cash settlements are recorded in interest expense. At February 29, 2012 and May 31, 2011, we did not have any derivative instruments that were accounted for using hedge accounting. Gains and losses recorded on the condensed consolidated statements of operations for our interest rate swaps are summarized below:

|                                 | For the three months ended |                         | For the nine months ended |                         |
|---------------------------------|----------------------------|-------------------------|---------------------------|-------------------------|
|                                 | February 29,<br>2012       | February<br>28,<br>2011 | February<br>29,<br>2012   | February<br>28,<br>2011 |
| (dollar amounts in thousands)   |                            |                         |                           |                         |
| Derivative cash settlements (1) | \$ 531                     | \$ (850)                | \$ (283)                  | \$ (5,685)              |
| Derivative forward value        | (26,094)                   | 54,198                  | (184,604)                 | 28,090                  |
| Derivative (losses)<br>gains    | \$ (25,563)                | \$ 53,348               | \$ (184,887)              | \$ 22,405               |

(1) The nine months ended February 28, 2011 includes a \$3 million fee we paid to terminate an interest rate swap that match funded an RTFC loan that was prepaid during the period.

### Rating Triggers

Some of our interest rate swaps have credit risk-related contingent features referred to as rating triggers. Rating triggers are not separate financial instruments and are not required to be accounted for separately as derivatives. At February 29, 2012, the following notional amounts of derivative instruments had rating triggers based on our senior unsecured credit ratings from Moody's Investors Service or Standard & Poor's Corporation falling to a level specified in the applicable agreements and are grouped into the categories below. In calculating the payments and collections required upon termination, we netted the agreements for each counterparty, as allowed by the underlying master agreements. At February 29, 2012, our senior unsecured credit ratings from Moody's Investors Service and Standard & Poor's Corporation were A2 and A, respectively. At February 29, 2012, both Moody's Investors Service and Standard & Poor's Corporation had our ratings on stable outlook.

| (dollar amounts in thousands)     | Notional amount | Our required payment | Amount we would collect | Net total    |
|-----------------------------------|-----------------|----------------------|-------------------------|--------------|
| Mutual rating trigger if ratings: |                 |                      |                         |              |
| fall to Baa1/BBB+ (1)             | \$ 3,000        | \$ (230)             | \$ -                    | \$ (230)     |
| fall below Baa1/BBB+ (1)          | 7,107,125       | (239,161)            | 57,733                  | (181,428)    |
| Total                             | \$ 7,110,125    | \$ (239,391)         | \$ 57,733               | \$ (181,658) |

(1) Stated senior unsecured credit ratings are for Moody's Investors Service and Standard & Poor's Corporation, respectively. Under these rating triggers, if the credit rating for either counterparty falls to the level specified in the agreement, the other counterparty may, but is not obligated to, terminate the agreement. If either counterparty terminates the agreement, a net payment may be due from one counterparty to the other based on the fair value, excluding credit risk, of the underlying derivative instrument.

In addition to the rating triggers listed above, at February 29, 2012 we had a total notional amount of \$688 million of derivative instruments with one counterparty that would require the pledging of collateral totaling \$18 million (the fair value of such derivative instruments excluding credit risk) if our senior unsecured ratings from Moody's Investors Service were to fall below Baa2 or if the ratings from Standard & Poor's Corporation were to fall below BBB. The aggregate fair value of all interest rate swaps with rating triggers that were in a net liability position at February 29, 2012 was \$252 million.

### (8) Equity

In July 2011, the CFC Board of Directors authorized the allocation of the fiscal year 2011 net earnings as follows: \$1 million to the cooperative educational fund, \$92 million to members in the form of patronage capital and \$80 million to the members' capital reserve. In July 2011, the CFC Board of Directors authorized the retirement of allocated net earnings totaling \$46 million, representing 50 percent of the fiscal year 2011 allocation. This amount was returned to members in cash in September 2011. Future allocations and retirements of net earnings may be made annually as determined by the CFC Board of Directors with due regard for its financial condition. The CFC Board of Directors has the authority to change the current practice for allocating and retiring net earnings at any time, subject to applicable laws and regulations.

### (9) Guarantees

The following table summarizes total guarantees by type of guarantee and member class:

| (dollar amounts in thousands)             | February 29,<br>2012 | May 31,<br>2011 |
|---|----------------------|-----------------|
| Total by type:                            |                      |                 |
| Long-term tax-exempt bonds                | \$ 573,870           | \$ 599,935      |
| Indemnifications of tax benefit transfers | 53,507               | 59,895          |
| Letters of credit                         | 405,310              | 327,201         |
| Other guarantees                          | 117,122              | 117,957         |
| Total                                     | \$ 1,149,809         | \$ 1,104,988    |
| Total by member class:                    |                      |                 |
| CFC:                                      |                      |                 |
| Distribution                              | \$ 222,141           | \$ 217,099      |
| Power supply                              | 853,811              | 817,618         |
| Statewide and associate                   | 8,014                | 20,807          |
| CFC total                                 | 1,083,966            | 1,055,524       |
| RTFC                                      | 1,026                | 821             |
| NCSC                                      | 64,817               | 48,643          |
| Total                                     | \$ 1,149,809         | \$ 1,104,988    |

The maturities for the long-term tax-exempt bonds and the related guarantees run through calendar year 2042. Amounts in the table represent the outstanding principal amount of the guaranteed bonds. At February 29, 2012, our maximum potential exposure for the \$75 million of fixed-rate tax-exempt bonds is \$127 million, representing principal and interest. Of the amounts shown in the table above for long-term tax-exempt bonds, \$499 million and \$524 million as of February 29, 2012 and May 31, 2011, respectively, are adjustable or floating-rate bonds that may be converted to a fixed rate as specified in the applicable indenture for each bond offering. During the variable-rate period (including at the time of conversion to a fixed rate), we have, in return for a fee, unconditionally agreed to purchase bonds tendered or put for redemption if the remarketing agents have not previously sold such bonds to other investors. We are unable to determine the maximum amount of interest that we could be required to pay related to the remaining adjustable and floating-rate bonds. Many of these bonds have a call provision that in the event of a default would allow us to trigger the call provision. This would limit our exposure to future interest payments on these bonds. Our maximum potential exposure is secured by a mortgage lien on all of the system's assets and future revenue. If the debt is accelerated because of a determination that the interest thereon is not tax-exempt, the system's obligation to reimburse us for any guarantee payments will be treated as a long-term loan.

The maturities for the indemnifications of tax benefit transfers run through calendar year 2015. The amounts shown represent our maximum potential exposure for guaranteed indemnity payments. A member's obligation to reimburse CFC for any guarantee payments would be treated as a long-term loan to the extent of any cash received by the member at the outset of the transaction. This amount is secured by a mortgage lien on substantially all of the system's assets and future revenue. The remainder would be treated as a line of credit loan secured by a subordinated mortgage on substantially all of the member's property. Due to changes in federal tax law, no further guarantees of this nature are anticipated.

The maturities for letters of credit run through calendar year 2024. Additionally, letters of credit totaling \$7 million at February 29, 2012 have a term of one year and automatically extend for a period of one year unless we cancel the agreement within 120 days of maturity (in which case, the beneficiary may draw on the letter of credit). The amounts shown in the table above represent our maximum potential exposure, of which \$153 million is secured at February 29, 2012. When taking into consideration reimbursement obligation agreements that we have in place with other lenders, our maximum potential exposure related to \$34 million of letters of credit would be reduced to \$10 million in the event of default. At February 29, 2012, and May 31, 2011, the letters of credit include \$125 million and \$48 million, respectively, to provide the standby liquidity for adjustable and floating-rate tax-exempt bonds issued for the benefit of our members. We are unable to determine the maximum amount of interest that we could be required to pay related to these adjustable and floating-rate bonds. Security provisions include a mortgage lien on substantially all of the system's assets, future revenue and the system's investment in our commercial paper.

In addition to the letters of credit listed in the table, under master letters of credit facilities in place at February 29, 2012, we may be required to issue up to an additional \$793 million in letters of credit to third parties for the benefit of our members. Of this amount, \$620 million represents commitments that may be used for the issuance of letters of credit or line of credit loan advances, at the option of the borrower, and are included in unadvanced loan commitments for line of credit loans reported in Note 2, Loans and Commitments. Master letters of credit facilities subject to material adverse change clauses at the time of issuance totaled \$484 million at February 29, 2012. Prior to issuing a letter of credit, we would confirm that there has been no material adverse change in the business condition, financial or otherwise, of the borrower since the time the loan was approved and confirm that the borrower is currently in compliance with the letter of credit terms and conditions. The remaining commitment under master letters of credit facilities of \$309 million may be advanced as long as the borrower is in compliance with the terms and conditions of the facility.



The maturities for other guarantees run through calendar year 2025. The maximum potential exposure for these guarantees is \$118 million, all of which is unsecured.

At February 29, 2012 and May 31, 2011, we had \$369 million and \$280 million of guarantees representing 32 percent and 25 percent, respectively, of total guarantees, under which our right of recovery from our members was not secured.

#### Guarantee Liability

At February 29, 2012 and May 31, 2011, we recorded a guarantee liability of \$27 million and \$22 million, respectively, which represents the contingent and non-contingent exposures related to guarantees and liquidity obligations associated with our members' debt. The contingent guarantee liability at February 29, 2012 and May 31, 2011 was \$7 million and \$6 million, respectively, based on management's estimate of exposure to losses within the guarantee portfolio. The remaining balance of the total guarantee liability of \$20 million and \$16 million at February 29, 2012 and May 31, 2011, respectively, relates to our non-contingent obligation to stand ready to perform over the term of our guarantees and liquidity obligations that we have entered into or modified since January 1, 2003.

Activity in the guarantee liability account is summarized below:

|  | As of and for the three months<br>ended |                         | As of and for the nine months<br>ended |                         |
|--|---|-------------------------|--|-------------------------|
|  | February<br>29,<br>2012                 | February<br>28,<br>2011 | February<br>29,<br>2012                | February<br>28,<br>2011 |
| (dollar amounts in thousands)                    |   |                         |  |                         |
| Beginning balance                                | \$ 24,093                               | \$ 22,609               | \$ 22,217                              | \$ 22,984               |
| Net change in non-contingent liability           | 1,693                                   | 323                     | 3,641                                  | 330                     |
| Provision for (recovery of) guarantee liability  | 1,576                                   | 24                      | 1,504                                  | (358)                   |
| Ending balance                                   | \$ 27,362                               | \$ 22,956               | \$ 27,362                              | \$ 22,956               |
| Liability as a percentage of<br>total guarantees | 2.38%                                   | 2.03%                   | 2.38%                                  | 2.03%                   |

#### (10) Fair Value Measurement

Assets and liabilities measured at fair value on either a recurring or non-recurring basis on the condensed consolidated balance sheets at February 29, 2012 and May 31, 2011 consisted of investments in common stock, derivative instruments, foreclosed assets and collateral-dependent non-performing loans.

##### Assets and Liabilities Measured at Fair Value on a Recurring Basis

We account for derivative instruments (including certain derivative instruments embedded in other contracts) in the condensed consolidated balance sheets as either an asset or liability measured at fair value. Since there is not an active secondary market for the types of interest rate swaps we use, we obtain market quotes from the interest rate swap counterparties to adjust all swaps to fair value on a quarterly basis. The market quotes are based on the expected future cash flow and the estimated yield curve.

We perform analysis to validate the market quotes obtained from our swap counterparties. We adjust the market values received from the counterparties using credit default swap levels for us and the counterparties. The credit default swap levels represent the credit risk premium required by a market participant based on the available information related to us and the counterparty. We only enter into exchange agreements with counterparties that are participating in our revolving lines of credit at the time the exchange agreements are executed. All of our exchange agreements are subject to master netting agreements.

Our valuation techniques for interest rate swaps are based on observable inputs, which reflect market data. Fair values for our interest rate swaps are classified as a Level 2 valuation. We record the change in the fair value of our derivatives for each reporting period in the derivative gains (losses) line, included in non-interest income in the condensed consolidated statements of operations, as currently none of our derivatives qualify for hedge accounting.

At February 29, 2012 and May 31, 2011, our investments in equity securities included investments in the Federal Agricultural Mortgage Corporation Series A common stock that is recorded in the condensed consolidated balance sheets at fair value. We calculate fair value based on the quoted price on the stock exchange where the stock is traded. That stock exchange is an active market based on the volume of shares transacted. Fair values for these securities are classified as a Level 1 valuation.

The following table presents our assets and liabilities that are measured at fair value on a recurring basis:

| February 29, 2012 | May 31, 2011 |
|-------------------|--------------|
|-------------------|--------------|

| (dollar amounts in thousands) | Level 1 | Level 2    | Level 1 | Level 2    |
|-------------------------------|---------|------------|---------|------------|
| Derivative assets             | \$ -    | \$ 301,629 | \$ -    | \$ 343,760 |
| Derivative liabilities        | -       | 620,392    | -       | 477,433    |
| Investments in common stock   | 1,143   | -          | 1,023   | -          |

#### Assets and Liabilities Measured at Fair Value on a Non-recurring Basis

We may be required, from time to time, to measure certain assets at fair value on a non-recurring basis in accordance with GAAP. Any adjustments to fair value usually result from application of lower-of-cost or fair value accounting or write-downs of individual assets. At February 29, 2012 and May 31, 2011, we measured foreclosed assets and certain collateral-dependent non-performing loans at fair value as described below.

Our foreclosed assets are initially recorded at the fair value of the underlying assets. Foreclosed assets are tested for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If there is an indicator of impairment, we perform a fair value analysis based on estimated future cash flows or in some instances, an assessment of the fair value of the asset or business, which may be provided by a third-party consultant. Estimates of future

cash flows are subjective and are considered to be a significant input in the valuation. A review for significant changes in the key assumptions and estimates of the fair value analysis is performed on a quarterly basis.

In certain instances when a loan is non-performing, we utilize the collateral fair value underlying the loan, which may be provided by a third-party consultant, in estimating the specific loan loss allowance. In these instances, the valuation is considered to be a non-recurring item.

Assets measured at fair value on a non-recurring basis at February 29, 2012 and May 31, 2011 were classified as Level 3 within the fair value hierarchy. The following table provides the carrying/fair value of the related individual assets at February 29, 2012 and May 31, 2011 and the total losses for the three and nine months ended February 29, 2012 and February 28, 2011.

|  | Level 3 Fair Value |              | Total losses for the three months ended |                   | Total losses for the nine months ended |                   |
|--|--------------------|--------------|---|-------------------|--|-------------------|
|  | February 29, 2012  | May 31, 2011 | February 29, 2012                       | February 28, 2011 | February 29, 2012                      | February 28, 2011 |
| (dollar amounts in thousands)                  |                    |              |   |                   |  |                   |
| Foreclosed assets, net                         | \$ 16,449          | \$ 280,811   | \$ (597)                                | \$ (818)          | \$ (2,686)                             | \$ (2,673)        |
| Non-performing loans, net of specific reserves | 19,238             | 10,509       | -                                       | (1,014)           | (1,863)                                | -                 |

#### (11) Fair Value of Financial Instruments

Carrying and fair values for our financial instruments are presented as follows:

| (dollar amounts in thousands)      | February 29, 2012 |            | May 31, 2011   |            |
|------------------------------------|-------------------|------------|----------------|------------|
|                                    | Carrying value    | Fair value | Carrying value | Fair value |
| <b>Assets:</b>                     |                   |            |                |            |
| Cash and cash equivalents          | \$ 381,394        | \$ 381,394 | \$ 293,615     | \$ 293,615 |
| Restricted cash                    | 1,083,466         | 1,083,466  | 7,690          | 7,690      |
| Investments in equity securities   | 58,721            | 58,721     | 58,601         | 58,601     |
| Loans to members, net              | 18,469,264        | 20,001,198 | 19,169,620     | 19,804,116 |
| Debt service reserve funds         | 39,803            | 39,803     | 45,662         | 45,662     |
| Interest rate exchange agreements  | 301,629           | 301,629    | 343,760        | 343,760    |
| <b>Liabilities:</b>                |                   |            |                |            |
| Short-term debt                    | 5,809,418         | 5,816,971  | 5,842,924      | 5,923,611  |
| Long-term debt                     | 11,714,358        | 13,384,763 | 11,293,249     | 12,700,219 |
| Guarantee liability                | 27,362            | 30,291     | 22,217         | 25,264     |
| Interest rate exchange agreements  | 620,392           | 620,392    | 477,433        | 477,433    |
| Subordinated deferrable debt       | 186,440           | 189,172    | 186,440        | 188,399    |
| Members' subordinated certificates | 1,741,320         | 1,900,141  | 1,801,212      | 1,961,005  |

Off-balance sheet instruments:

Commitments - - - -

See Note 10, Fair Value Measurement, for more details on assets and liabilities measured at fair value on a recurring or non-recurring basis on our condensed consolidated balance sheets. We consider relevant and observable prices in the appropriate principal market in our valuations where possible. The estimated fair value information presented is not necessarily indicative of amounts we could realize currently in a market sale since we may be unable to sell such instruments due to contractual restrictions or the lack of an established market.

The estimated market values have not been updated since February 29, 2012; therefore, current estimates of fair value may differ significantly from the amounts presented. With the exception of redeeming debt under early redemption provisions, terminating derivative instruments under early termination provisions and allowing borrowers to prepay their loans, we held and intend to hold all financial instruments to maturity excluding common stock investments that have no stated maturity. Below is a summary of significant methodologies used in estimating fair value amounts at February 29, 2012 and May 31, 2011.

#### Cash and Cash Equivalents

Includes cash and certificates of deposit with original maturities of less than 90 days. Cash and cash equivalents are valued at the carrying value, which approximates fair value.

#### Restricted Cash

Restricted cash consists of cash and cash equivalents for which use is contractually restricted. Restricted cash is valued at the carrying value, which approximates fair value.

#### Investments in Equity Securities

Our investments in equity securities included investments in the Federal Agricultural Mortgage Corporation Series A common stock and Series C preferred stock. The Series A common stock is classified as available-for-sale securities and recorded in the condensed consolidated balance sheets at fair value. We calculate fair value based on the quoted price on the stock exchange where the stock is traded. That stock exchange is an active market based on the volume of shares transacted.

Our investments in equity securities also included investments in Federal Agricultural Mortgage Corporation Series C non-voting, cumulative preferred stock purchased based on a percentage of debt issued under note purchase agreements. The note purchase agreements have since been amended so that we may be required to purchase additional Series C preferred stock based on the terms and circumstances at the time of each advance. The fair value for the Series C preferred stock is estimated at cost, which approximates fair value as the preferred stock securities do not meet the definition of marketable securities and the stock is callable at par. These securities carry with it a netting provision against our debt held by Federal Agricultural Mortgage Corporation in case of non-payment, therefore transferability of these securities is unlikely.

#### Loans to Members, Net

As part of receiving a loan from us, our members have additional requirements and rights that are not typical of other financial institutions, such as the ability to receive a patronage capital allocation, the general requirement to purchase subordinated certificates or member capital securities to meet their capital contribution requirements as a condition of obtaining additional credit from us, the option to select fixed rates from one year to maturity with the fixed rate resetting or repricing at the end of each selected rate term, the ability to convert from a fixed rate to another fixed rate or the variable rate at any time, and certain interest rate discounts that are specific to the borrower's activity with us. These features make it difficult to obtain market data for similar loans. Therefore, we must use other methods to estimate the fair value.

Fair values for fixed-rate loans are estimated by discounting the future cash flows using the current rates at which we would make similar loans to new borrowers for the same remaining maturities. The maturity date used in the fair value calculation of loans with a fixed rate for a selected rate term is the next repricing date since these borrowers must reprice their loans at various times throughout the life of the loan at the then-current market rate.

Loans with different risk characteristics, specifically non-performing and restructured loans, are valued by using collateral valuations or by adjusting cash flows for credit risk and discounting those cash flows using the current rates at which similar loans would be made by us to borrowers for the same remaining maturities. See Note 10, Fair Value Measurement, for more details about how we calculate the fair value of certain non-performing loans.

Variable-rate loans are valued at cost, which approximates fair value since we can reset rates every 15 days.

Credit risk for the loan portfolio is estimated based on the associated reserve in our allowance for loan losses.

#### Debt Service Reserve Funds

Debt service reserve funds represent cash and/or investments on deposit with the bond trustee for tax-exempt bonds that we guarantee. Carrying value is considered to be equal to fair value.

#### Short-Term Debt

Short-term debt consists of commercial paper, bank bid notes and other debt due within one year. The fair value of short-term debt with maturities greater than 90 days is estimated based on quoted market rates for debt with similar maturities. The fair value of short-term debt with maturities less than or equal to 90 days is carrying value, which is a reasonable estimate of fair value.

#### Long-Term Debt

Long-term debt consists of collateral trust bonds, medium-term notes and long-term notes payable. We issue all collateral trust bonds and some medium-term notes in underwritten public transactions. There is not active secondary trading for all

underwritten collateral trust bonds and medium-term notes; therefore, dealer quotes and recent market prices are both used in estimating fair value. There is essentially no secondary market for the medium-term notes issued to our members or in transactions that are not underwritten; therefore, fair value is estimated based on observable benchmark yields and spreads for similar instruments supplied by banks that underwrite our other debt transactions. The long-term notes payable are issued in private placement transactions and there is no secondary trading of such debt. Therefore, the fair value is estimated based on underwriter quotes for similar instruments, if available, or based on cash flows discounted at current rates for similar instruments supplied by underwriters or by the original issuer. Secondary trading quotes for our debt instruments used in the determination of fair value incorporate our credit risk.

#### Subordinated Deferrable Debt

Our subordinated deferrable debt is traded on the New York Stock Exchange; therefore, daily market quotes are available. The fair value for subordinated deferrable debt is based on the closing market quotes from the last day of the reporting period.

#### Members' Subordinated Certificates

Members' subordinated certificates include (i) membership subordinated certificates issued to our members as a condition of membership, (ii) loan and guarantee subordinated certificates as a condition of obtaining loan funds or guarantees and (iii) member capital securities issued as voluntary investments by our members. All members' subordinated certificates are non-transferable other than among members. As there is no ready market from which to obtain fair value quotes for membership, loan and guarantee subordinated certificates, it is impracticable to estimate fair value, and such certificates are, therefore, valued at par. There also is no ready market from which to obtain fair value quotes for member capital securities. Fair value for member capital securities is based on the discounted cash flows using the coupon interest rate on the last business day of the reporting period.

#### Derivative Instruments

We record derivative instruments in the condensed consolidated balance sheets as either an asset or liability measured at fair value. Because there is not an active secondary market for the types of interest rate swaps we use, we obtain market quotes from the interest rate swap counterparties to adjust all interest rate swaps to fair value on a quarterly basis. The market quotes are based on the expected future cash flow and estimated yield curves. We adjust the market values received from the counterparties using credit default swap levels for us and the counterparties. The credit default swap levels represent the credit risk premium required by a market participant based on the available information related to us and the counterparty.

#### Commitments

The fair value of our commitments is estimated as the carrying value, or zero. Extensions of credit under these commitments, if exercised, would result in loans priced at market rates.

#### Guarantees

The fair value of our guarantee liability is based on the fair value of our contingent and non-contingent exposure related to our guarantees. The fair value of our contingent exposure for guarantees is based on management's estimate of our exposure to losses within the guarantee portfolio. The fair value of our non-contingent exposure for guarantees issued is estimated based on the total unamortized balance of guarantee fees paid and guarantee fees to be paid discounted at our current short-term funding rate, which represents management's estimate of the fair value of our obligation to stand ready to perform.



## (12) Segment Information

The following tables contain the segment presentation for the condensed consolidated statements of operations for the nine months ended February 29, 2012 and February 28, 2011 and condensed consolidated balance sheets at February 29, 2012 and February 28, 2011.

| (dollar amounts in thousands)                     | For the nine months ended February 29, 2012 |              |                |               |
|---|---|--------------|----------------|---------------|
|   | CFC   | Other        | Elimination    | Consolidated  |
| <b>Statement of operations:</b>                   |   |              |                |               |
| Interest income                                   | \$ 709,342                                  | \$ 51,581    | \$ (37,900)    | \$ 723,023    |
| Interest expense                                  | (585,846)                                   | (39,075)     | 37,903         | (587,018)     |
| Net interest income                               | 123,496                                     | 12,506       | 3              | 136,005       |
| Recovery of loan losses                           | 11,862                                      | -            | -              | 11,862        |
| Net interest income after recovery of loan losses | 135,358                                     | 12,506       | 3              | 147,867       |
| <b>Non-interest income:</b>                       |   |              |                |               |
| Fee and other income                              | 13,660                                      | 824          | (1,059)        | 13,425        |
| Derivative losses                                 | (173,361)                                   | (11,526)     | -              | (184,887)     |
| Results of operations from foreclosed assets      | (59,349)                                    | -            | -              | (59,349)      |
| Total non-interest income                         | (219,050)                                   | (10,702)     | (1,059)        | (230,811)     |
| <b>Non-interest expense:</b>                      |   |              |                |               |
| General and administrative expenses               | (43,638)                                    | (6,609)      | 572            | (49,675)      |
| Provision for guarantee liability                 | (1,504)                                     | -            | -              | (1,504)       |
| Fair value adjustment on foreclosed assets        | (2,686)                                     | -            | -              | (2,686)       |
| Loss on early extinguishment of debt              | (15,525)                                    | -            | -              | (15,525)      |
| Other   | (991)                                       | (484)        | 484            | (991)         |
| Total non-interest expense                        | (64,344)                                    | (7,093)      | 1,056          | (70,381)      |
| Loss prior to income taxes                        | (148,036)                                   | (5,289)      | -              | (153,325)     |
| Income tax benefit                                | -   | 2,110        | -              | 2,110         |
| Net loss  | \$ (148,036)                                | \$ (3,179)   | \$ -           | \$ (151,215)  |
| <b>Assets:</b>                                    |   |              |                |               |
| Total loans outstanding                           | \$ 18,579,726                               | \$ 1,164,535 | \$ (1,133,037) | \$ 18,611,224 |
| Deferred origination costs                        | 7,514                                       | -            | -              | 7,514         |
| Less: Allowance for loan losses                   | (149,474)                                   | -            | -              | (149,474)     |
| Loans to members, net                             | 18,437,766                                  | 1,164,535    | (1,133,037)    | 18,469,264    |
| Other assets                                      | 2,432,025                                   | 161,992      | (130,903)      | 2,463,114     |
| Total assets                                      | \$ 20,869,791                               | \$ 1,326,527 | \$ (1,263,940) | \$ 20,932,378 |



| (dollar amounts in thousands)                     | For the nine months ended February 28, 2011 |              |                |               |
|---|---|--------------|----------------|---------------|
|   | CFC   | Other        | Elimination    | Consolidated  |
| <b>Statement of operations:</b>                   |   |              |                |               |
| Interest income                                   | \$ 739,273                                  | \$ 62,667    | \$ (46,067)    | \$ 755,873    |
| Interest expense                                  | (636,941)                                   | (47,432)     | 46,127         | (638,246)     |
| Net interest income                               | 102,332                                     | 15,235       | 60             | 117,627       |
| Recovery of loan losses                           | 42,884                                      | 31           | -              | 42,915        |
| Net interest income after recovery of loan losses | 145,216                                     | 15,266       | 60             | 160,542       |
| <b>Non-interest income:</b>                       |   |              |                |               |
| Fee and other income                              | 20,314                                      | 983          | (2,201)        | 19,096        |
| Derivative gains (losses) gains                   | 26,295                                      | (3,922)      | 32             | 22,405        |
| Results of operations from foreclosed assets      | (6,323)                                     | -            | -              | (6,323)       |
| Total non-interest income                         | 40,286                                      | (2,939)      | (2,169)        | 35,178        |
| <b>Non-interest expense:</b>                      |   |              |                |               |
| General and administrative expenses               | (48,807)                                    | (7,118)      | 1,281          | (54,644)      |
| Recovery of guarantee liability                   | 358   | -            | -              | 358           |
| Fair value adjustment on foreclosed assets        | (2,673)                                     | -            | -              | (2,673)       |
| Loss on early extinguishment of debt              | (3,928)                                     | -            | -              | (3,928)       |
| Other   | (864)                                       | (835)        | 828            | (871)         |
| Total non-interest expense                        | (55,914)                                    | (7,953)      | 2,109          | (61,758)      |
| Income prior to income taxes                      | 129,588                                     | 4,374        | -              | 133,962       |
| Income tax expense                                | -   | (1,983)      | -              | (1,983)       |
| Net income  | \$ 129,588                                  | \$ 2,391     | \$ -           | \$ 131,979    |
| <b>Assets:</b>                                    |   |              |                |               |
| Total loans outstanding                           | \$ 19,141,948                               | \$ 1,464,933 | \$ (1,080,597) | \$ 19,526,284 |
| Deferred origination costs                        | 5,885                                       | -            | -              | 5,885         |
| Less: Allowance for loan losses                   | (222,222)                                   | (2)          | -              | (222,224)     |
| Loans to members, net                             | 18,925,611                                  | 1,464,931    | (1,080,597)    | 19,309,945    |
| Other assets                                      | 1,422,228                                   | 243,302      | (212,820)      | 1,452,710     |
| Total assets                                      | \$ 20,347,839                               | \$ 1,708,233 | \$ (1,293,417) | \$ 20,762,655 |



The following tables contain the segment presentation for the condensed consolidated statements of operations for the three months ended February 29, 2012 and February 28, 2011.

| (dollar amounts in thousands)                       | For the three months ended February 29, 2012 |           |             |              |
|---|--|-----------|-------------|--------------|
|   | CFC  | Other     | Elimination | Consolidated |
| Statement of operations:                            |  |           |             |              |
| Interest income                                     | \$ 234,148                                   | \$ 15,128 | \$ (11,258) | \$ 238,018   |
| Interest expense                                    | (189,835)                                    | (11,716)  | 11,257      | (190,294)    |
| Net interest income                                 | 44,313                                       | 3,412     | (1)         | 47,724       |
| Provision for loan losses                           | (263)  | -         | -           | (263)        |
| Net interest income after provision for loan losses | 44,050                                       | 3,412     | (1)         | 47,461       |
| Non-interest income:                                |  |           |             |              |
| Fee and other income                                | 4,514  | 393       | (191)       | 4,716        |
| Derivative losses                                   | (23,890)                                     | (1,673)   | -           | (25,563)     |
| Results of operations from foreclosed assets        | (44,972)                                     | -         | -           | (44,972)     |
| Total non-interest income                           | (64,348)                                     | (1,280)   | (191)       | (65,819)     |
| Non-interest expense:                               |  |           |             |              |
| General and administrative expenses                 | (14,596)                                     | (2,190)   | 192         | (16,594)     |
| Provision for guarantee liability                   | (1,576)                                      | -         | -           | (1,576)      |
| Fair value adjustment on foreclosed assets          | (597)  | -         | -           | (597)        |
| Other   | (176)  | -         | -           | (176)        |
| Total non-interest expense                          | (16,945)                                     | (2,190)   | 192         | (18,943)     |
| Loss prior to income taxes                          | (37,243)                                     | (58)      | -           | (37,301)     |
| Income tax benefit                                  | -  | 2         | -           | 2            |
| Net loss  | \$ (37,243)                                  | \$ (56)   | \$ -        | \$ (37,299)  |

| (dollar amounts in thousands)                     | For the three months ended February 28, 2011 |           |             |              |
|---|--|-----------|-------------|--------------|
|   | CFC  | Other     | Elimination | Consolidated |
| Statement of operations:                          |  |           |             |              |
| Interest income                                   | \$ 248,280                                   | \$ 21,059 | \$ (15,037) | \$ 254,302   |
| Interest expense                                  | (205,955)                                    | (15,435)  | 15,057      | (206,333)    |
| Net interest income                               | 42,325                                       | 5,624     | 20          | 47,969       |
| Recovery of loan losses                           | 3,374  | -         | -           | 3,374        |
| Net interest income after recovery of loan losses | 45,699                                       | 5,624     | 20          | 51,343       |
| Non-interest income:                              |  |           |             |              |
| Fee and other income                              | 4,369  | 272       | (681)       | 3,960        |

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|  |           |          |       |           |
|--|-----------|----------|-------|-----------|
| Derivative gains                           | 49,693    | 3,644    | 11    | 53,348    |
| Results of operations of foreclosed assets | (4,854)   | -        | -     | (4,854)   |
| Total non-interest income                  | 49,208    | 3,916    | (670) | 52,454    |
| Non-interest expense:                      |           |          |       |           |
| General and administrative expenses        | (14,085)  | (2,161)  | 176   | (16,070)  |
| Provision for guarantee liability          | (24)      | -        | -     | (24)      |
| Fair value adjustment of foreclosed assets | (818)     | -        | -     | (818)     |
| Other                                      | (643)     | (475)    | 474   | (644)     |
| Total non-interest expense                 | (15,570)  | (2,636)  | 650   | (17,556)  |
| Income prior to income taxes               | 79,337    | 6,904    | -     | 86,241    |
| Income tax expense                         | -         | (2,589)  | -     | (2,589)   |
| Net income                                 | \$ 79,337 | \$ 4,315 | \$ -  | \$ 83,652 |

(13) Subsequent Events

On March 1, 2012, we paid down \$1 billion of medium-term notes scheduled to mature on that date with restricted cash on hand at February 29, 2012. Additionally, on March 1, 2012, \$1 billion of interest rate swaps matured under which we receive a fixed rate and pay a variable rate. At February 29, 2012, there was a favorable spread of approximately 530 basis points between the rate we received and the rate we paid on these swaps.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis is designed to provide a better understanding of our financial condition and results of operations and as such should be read in conjunction with the condensed consolidated financial statements, including the notes thereto and the information contained elsewhere in this Form 10-Q, including Part I, Item 1A. Risk Factors in our Form 10-K for the year ended May 31, 2011.

Unless stated otherwise, references to "we," "our" or "us" relate to the consolidation of National Rural Utilities Cooperative Finance Corporation ("CFC"), Rural Telephone Finance Cooperative ("RTFC"), National Cooperative Services Corporation ("NCSC") and certain entities created and controlled by CFC to hold foreclosed assets and to accommodate loan securitization transactions.

This Form 10-Q contains forward-looking statements defined by the Securities Act of 1933, as amended, and the Exchange Act of 1934, as amended. Forward-looking statements, which are based on certain assumptions and describe our future plans, strategies and expectations, are generally identified by our use of words such as "intend," "plan," "may," "should," "will," "project," "estimate," "anticipate," "believe," "expect," "continue," "potential," "opportunity" and similar expressions, whether in the negative or affirmative. All statements about future expectations or projections, including statements about loan volume, the adequacy of the loan loss allowance, operating income and expenses, leverage and debt-to-equity ratios, borrower financial performance, impaired loans, and sources and uses of liquidity, are forward-looking statements. Although we believe that the expectations reflected in our forward-looking statements are based on reasonable assumptions, actual results and performance could materially differ. Factors that could cause future results to vary from current expectations include, but are not limited to, general economic conditions, legislative changes including those that could affect our tax status, governmental monetary and fiscal policies, demand for our loan products, lending competition, changes in the quality or composition of our loan portfolio, changes in our ability to access external financing, changes in the credit ratings on our debt, valuations of collateral supporting impaired loans, charges associated with our operation or disposition of foreclosed assets, regulatory and economic conditions in the rural electric industry, non-performance of counterparties to our derivative agreements and the costs and effects of legal or governmental proceedings involving CFC or its members. Some of these and other factors are discussed in our annual and quarterly reports previously filed with the Securities and Exchange Commission ("SEC"). Except as required by law, we undertake no obligation to update or publicly release any revisions to forward-looking statements to reflect events, circumstances or changes in expectations after the date on which the statement is made.

#### Executive Summary

Throughout this management discussion and analysis, we will refer to certain of our financial measures that are not in accordance with generally accepted accounting principles in the United States ("GAAP") as "adjusted." In our Executive Summary, our discussion focuses on the key metrics that we use to evaluate our business, which are adjusted times interest earned ratio ("TIER") and adjusted debt-to-equity ratio. The most closely related GAAP measures are TIER and debt-to-equity ratio. We do not measure our performance or evaluate our business based on the GAAP measures, and the financial covenants in our revolving credit agreements and debt indentures are based on our adjusted measures rather than the related GAAP measures. The main adjustments we make to calculate the non-GAAP measures compared with the related GAAP measures are to adjust interest expense to include derivative cash settlements; to adjust net income, senior debt and total equity to exclude the non-cash adjustments from the accounting for derivative financial instruments; to exclude from senior debt the amount that funds loans guaranteed by the Rural Utilities Service ("RUS"), subordinated deferrable debt and members' subordinated certificates; and to adjust total equity to include subordinated deferrable debt and members' subordinated certificates. See Non-GAAP Financial Measures for further explanation of the adjustments we make to our financial results for our own analysis and covenant compliance



and for a reconciliation to the related GAAP measures.

Our primary objective as a member-owned cooperative lender is to provide cost-based financial products to our rural electric and telecommunications members while maintaining sound financial results required for investment-grade credit ratings on our debt instruments. Our objective is not to maximize net income; therefore, the rates we charge our borrowers reflect our adjusted interest expense plus a spread to cover our operating expenses, a provision for loan losses and earnings sufficient to achieve interest coverage to meet our financial objectives. Our goal is to earn an annual minimum adjusted TIER of 1.10 and to achieve and maintain an adjusted debt-to-equity ratio of no greater than 6.00-to-1.

#### Lending Activity

Loans outstanding at February 29, 2012 decreased by \$713 million from the prior fiscal year end. There was an increase of \$297 million during the third quarter, which partially offset the \$1,010 million decrease in loans during the first six months of fiscal year 2012. The \$713 million decrease in loans outstanding during the nine months ended February 29, 2012 was largely

due to the \$520 million decrease in CFC power supply loans driven primarily by the repayment of bridge loans with RUS funding or member capital market issuances. There was also the maturity of a \$200 million loan to a RTFC borrower during the nine months ended February 29, 2012 which was the primary contributor to the \$279 million decrease in RTFC loans outstanding.

During the nine months ended February 29, 2012, \$1,337 million of CFC long-term fixed-rate loans were scheduled to reprice. Of this total, \$1,073 million selected a new long-term fixed rate; \$170 million selected the long-term variable rate; \$32 million selected a new rate offered as part of our loan sale program and were sold by CFC with CFC continuing to service the loans sold; and \$62 million were prepaid in full.

#### Funding Activity

During the nine months ended February 29, 2012, total debt outstanding increased \$328 million. The increase was primarily due to the \$1,164 million increase in cash and restricted cash balances offset by the \$713 million reduction to the balance of loans outstanding. The increase in the cash balances at February 29, 2012 was due to the prefunding of the \$1 billion medium-term note scheduled to mature on March 1, 2012. As a result of the \$713 million decrease in loans outstanding, our funding requirements during the nine months ended February 29, 2012 were primarily related to the early redemption of \$500 million of medium-term notes scheduled to mature on March 1, 2012 and prefunding the remaining \$1 billion of medium-term notes scheduled to mature on that date. We met these funding needs primarily with scheduled loan repayments and with the issuance of collateral trust bonds in February 2012 totaling \$800 million. During the nine months ended February 29, 2012, we reduced the utilization of medium-term notes in our overall funding mix resulting in a lower average balance of medium-term notes outstanding of 18 percent of total average debt volume, compared with 21 percent of total average debt volume for the prior-year period. We refinanced maturing commercial paper as needed and slightly increased commercial paper, daily liquidity fund and bank bid notes as a percentage of total average debt volume to 16 percent compared with 15 percent for the prior-year period.

In October 2011, we terminated two of our syndicated revolving credit agreements prior to their maturities and replaced them with two new facilities. The refinancing resulted in a \$714 million decrease to the total commitment under revolving lines of credit that total \$2,845 million at February 29, 2012. The fees on the new agreements are lower resulting in savings to us. Additionally, the maturity dates of the two new commitments are October 2015 and 2016 compared with maturity dates of March 2012 and 2013 under the old commitments. The reduction in the total commitment under the facilities also reduces the total amount of commercial paper that we may issue.

#### Financial Results

For the nine months ended February 29, 2012 and February 28, 2011, we reported a net loss of \$151 million and net income of \$132 million, respectively, and TIER was below 1.00 and was 1.21, respectively. As previously mentioned, we use adjusted non-GAAP measures in our analysis to evaluate our performance and for covenant compliance. For the nine months ended February 29, 2012 and February 28, 2011, adjusted net income was \$33 million and \$104 million, respectively, and adjusted TIER was 1.06 and 1.16, respectively.

Our interest income decreased by \$33 million or 4 percent for the nine months ended February 29, 2012 as compared to the prior-year period. The decrease to interest income was due to a lower average rate earned on the loan portfolio and a 4 percent decrease in the average loans outstanding. There was a decrease to interest income earned in each loan program, except for restructured loans. The increase to the interest income recognized on restructured loans was due to placing a \$420 million restructured loan on accrual status on October 1, 2011. There was a decrease to the average balance outstanding in every loan program except for the long-term fixed rate program. However, the 2 percent increase in the average balance of long-term fixed rate loans was not sufficient to offset the 22 bps decrease to the average yield earned on fixed rate loans. Long-term fixed rate loans have a higher average rate than long-term variable and line of credit loans and represented 88 percent of the total average loan balance for the nine months ended February 29, 2012 as compared to 84 percent for the prior-year period.

Our adjusted interest expense for the nine months ended February 29, 2012 declined by \$57 million as compared with the prior-year period. Our adjusted interest expense averaged approximately \$65 million per month, a decrease of approximately \$7 million, or 10 percent, from an approximate average of \$72 million per month for the prior-year period. The factors contributing to this decrease to adjusted interest expense include (i) the refinancing of maturing debt completed in the prior year, (ii) a decrease in the utilization of medium-term notes in our overall funding mix and (iii) a decrease in the total average debt balance outstanding. Adjusted interest expense decreased \$41 million compared to the prior-year period including the \$16 million loss recorded in August and October 2011 related to premium costs paid for the early redemption of \$500 million of 7.25 percent medium-term notes during the nine months ended February 29, 2012.

During the quarter ended February 29, 2012, we recorded impairment charges for goodwill and other assets related to our Caribbean Asset Holdings LLC (“CAH”) subsidiary totaling \$45 million. CAH holds our investment in cable and telecommunications operating entities in the United States Virgin Islands, British Virgin Islands and St. Maarten. In addition to the impairment charges, the results of operations of foreclosed assets included a net loss of \$14 million related to the operations of CAH for the nine months ended February 29, 2012, compared to a net loss of \$6 million, for the prior-year period. CAH took control of a non-performing borrowers’ operating entities in the United States Virgin Islands on October 1, 2010 and operating entities in the British Virgin Islands and St. Maarten on March 1, 2011. The results of operations and goodwill and other asset impairment charges for CAH are excluded from our financial results used to calculate our compliance with debt covenants under our existing indentures and credit facility agreements.

At February 29, 2012, our debt-to-equity ratio increased to 41.84 -to-1 compared with 28.92-to-1 at May 31, 2011. As mentioned previously, we use adjusted non-GAAP measures in our own analysis to evaluate our performance and for covenant compliance. Our adjusted debt-to-equity ratio increased to 6.42 -to-1 at February 29, 2012 compared with 6.09-to-1 at May 31, 2011 primarily due to a higher debt balance at February 29, 2012 resulting from prefunding \$1 billion of medium-term notes that matured on March 1, 2012. Excluding the \$1 billion of medium-term notes and accrued interest paid down on March 1, 2012 with restricted cash on hand at February 29, 2012, the adjusted debt to equity ratio was 6.03 -to-1.

#### Outlook for the Next 12 Months

We expect the amount of new long-term loan advances over the next 12 months to approximate scheduled long-term loan repayments. As a result of a fairly stable loan portfolio, we do not anticipate significant changes to our interest income over the next 12 months. We do expect there to be a continued slight decrease to our adjusted interest expense over the next 12 months due to the refunding actions taken over the past year, including the refinancing of the \$1 billion of 7.25 percent medium-term notes on March 1, 2012 primarily with the proceeds of an \$800 million collateral trust bond issuance at an average fixed rate of 2.03 percent completed in February 2012. We expect the benefit from the maturity of the \$1 billion of medium-term notes on March 1, 2012 to be significantly reduced by the maturity of \$1 billion of interest rate swaps under which we received a fixed rate and paid a variable rate. At February 29, 2012, there was a favorable spread of approximately 530 basis points between the rate we received and the rate we paid on the \$1 billion of interest rate swaps that matured on March 1, 2012.

In addition to the \$1 billion of medium-term notes that matured on March 1, 2012, we have an additional \$1,409 million of long-term debt scheduled to mature over the next 12 months. We believe that we have sufficient liquidity from the combination of member loan repayments and our ability to issue debt in the capital markets, to our members and in private placements to satisfy member loan advances and meet our need to fund long-term debt maturing over the next 12 months. At February 29, 2012, we had up to \$849 million available under committed loan facilities from the Federal Financing Bank, \$2,837 million available under committed revolving lines of credit and, subject to market conditions, up to \$2,489 million available under a revolving note purchase agreement with the Federal Agriculture Mortgage Corporation. We also have the ability to issue collateral trust bonds and medium-term notes in the capital markets and medium-term notes to members. We believe we can rollover the \$3,400 million of commercial paper, daily liquidity fund and bank bid notes scheduled to mature during the next 12 months as of February 29, 2012 as we expect to continue to maximize the utilization of these short-term funding options. We expect to be in compliance with the covenants under our revolving credit agreements; therefore, we could draw on these facilities to repay dealer or member commercial paper that cannot be rolled over in the event of market disruptions.

As mentioned earlier, the adjusted debt to equity ratio was 6.03 -to-1 at February 29, 2012 excluding the \$1 billion of medium-term notes and accrued interest paid down on March 1, 2012 with restricted cash on hand. We expect to be able to maintain the adjusted debt to equity ratio at or below our target of 6.00-to-1 over the next 12 months.



## Results of Operations

The following table presents the results of operations for the three and nine months ended February 29, 2012 and February 28, 2011.

| (dollar amounts in thousands)                     | For the three months ended |                   |             | For the nine months ended |                   |             |
|---|----------------------------|-------------------|-------------|---------------------------|-------------------|-------------|
|   | February 29, 2012          | February 28, 2011 | Change      | February 29, 2012         | February 28, 2011 | Change      |
| Interest income                                   | \$ 238,018                 | \$ 254,302        | \$ (16,284) | \$ 723,023                | \$ 755,873        | \$ (32,850) |
| Interest expense                                  | (190,294)                  | (206,333)         | 16,039      | (587,018)                 | (638,246)         | 51,228      |
| Net interest income                               | 47,724                     | 47,969            | (245)       | 136,005                   | 117,627           | 18,378      |
| (Provision for) recovery of loan losses           | (263)                      | 3,374             | (3,637)     | 11,862                    | 42,915            | (31,053)    |
| Net interest income after recovery of loan losses | 47,461                     | 51,343            | (3,882)     | 147,867                   | 160,542           | (12,675)    |
| Non-interest income:                              |                            |                   |             |                           |                   |             |
| Fee and other income                              | 4,716                      | 3,960             | 756         | 13,425                    | 19,096            | (5,671)     |
| Derivative (losses) gains                         | (25,563)                   | 53,348            | (78,911)    | (184,887)                 | 22,405            | (207,292)   |
| Results of operations from foreclosed assets      | (44,972)                   | (4,854)           | (40,118)    | (59,349)                  | (6,323)           | (53,026)    |
| Total non-interest income                         | (65,819)                   | 52,454            | (118,273)   | (230,811)                 | 35,178            | (265,989)   |
| Non-interest expense:                             |                            |                   |             |                           |                   |             |
| Salaries and employee benefits                    | (10,959)                   | (9,700)           | (1,259)     | (31,191)                  | (32,420)          | 1,229       |
| Other general and administrative expenses         | (5,635)                    | (6,370)           | 735         | (18,484)                  | (22,224)          | 3,740       |
| (Provision for) recovery of guarantee liability   | (1,576)                    | (24)              | (1,552)     | (1,504)                   | 358               | (1,862)     |
| Fair value adjustment on foreclosed assets        | (597)                      | (818)             | 221         | (2,686)                   | (2,673)           | (13)        |
| Loss on early extinguishment of debt              | -                          | -                 | -           | (15,525)                  | (3,928)           | (11,597)    |
| Other   | (176)                      | (644)             | 468         | (991)                     | (871)             | (120)       |
| Total non-interest expense                        | (18,943)                   | (17,556)          | (1,387)     | (70,381)                  | (61,758)          | (8,623)     |
| (Loss) income prior to income taxes               | (37,301)                   | 86,241            | (123,542)   | (153,325)                 | 133,962           | (287,287)   |
| Income tax benefit (expense)                      | 2                          | (2,589)           | 2,591       | 2,110                     | (1,983)           | 4,093       |
| Net (loss) income                                 | (37,299)                   | 83,652            | (120,951)   | (151,215)                 | 131,979           | (283,194)   |
| Less: Net loss (income) attributable to           |                            |                   |             |                           |                   |             |

|                                       |             |           |              |              |            |              |
|---------------------------------------|-------------|-----------|--------------|--------------|------------|--------------|
| noncontrolling interest               | 56          | (4,315)   | 4,371        | 3,179        | (2,391)    | 5,570        |
| Net (loss) income attributable to CFC | \$ (37,243) | \$ 79,337 | \$ (116,580) | \$ (148,036) | \$ 129,588 | \$ (277,624) |

|                   |   |      |      |      |
|-------------------|---|------|------|------|
| TIER (1)          | - | 1.41 | -    | 1.21 |
| Adjusted TIER (2) | - | 1.14 | 1.06 | 1.16 |

(1) For the three and nine months ended February 29, 2012, we reported net losses of \$37 million and \$151 million, respectively, and, therefore, the TIER calculation for these periods result in a value below 1.00.

(2) Adjusted to exclude the effect of the derivative forward value from net income and to include all derivative cash settlements in the interest expense. The derivative forward value and derivative cash settlements are combined in the derivative losses line item in the chart above. See Non-GAAP Financial Measures for further explanation and a reconciliation of these adjustments.

## Interest Income

The following tables break out the average rate on loans and the change to interest income due to changes in average loan volume versus changes to interest rates summarized by loan type.

## Average balances and interest rates – Assets

|                               | February       |                      | For the three months ended |                      | February     |                         |
|-------------------------------|----------------|----------------------|----------------------------|----------------------|--------------|-------------------------|
|                               | 29,<br>2012    | February 28,<br>2011 | February<br>29,<br>2012    | February 28,<br>2011 | 29,<br>2012  | February<br>28,<br>2011 |
| (dollar amounts in thousands) | Average volume |                      | Interest income            |                      | Average rate |                         |
| Long-term fixed-rate loans    | \$ 16,359,852  | \$ 16,649,073        | \$ 216,948                 | \$ 227,118           | 5.33%        | 5.53%                   |
| Long-term variable-rate loans | 628,898        | 958,174              | 5,197                      | 12,041               | 3.32         | 5.10                    |
| Line of credit loans          | 1,046,042      | 1,398,706            | 7,243                      | 11,154               | 2.78         | 3.23                    |
| Restructured loans            | 458,495        | 483,792              | 5,761                      | 696                  | 5.05         | 0.58                    |
| Non-performing loans          | 42,525         | 101,426              | -                          | 149                  | -            | 0.60                    |
| Total                         | 18,535,812     | 19,591,171           | 235,149                    | 251,158              | 5.10         | 5.20                    |
| Investments                   | 606,773        | 316,417              | 1,305                      | 967                  | 0.87         | 1.24                    |
| Fee income (1)                | -              | -                    | 1,564                      | 2,177                | -            | -                       |
| Total                         | \$ 19,142,585  | \$ 19,907,588        | \$ 238,018                 | \$ 254,302           | 5.00         | 5.18                    |

## Average balances and interest rates – Assets

|                               | February       |                      | For the nine months ended |                      | February     |                         |
|-------------------------------|----------------|----------------------|---------------------------|----------------------|--------------|-------------------------|
|                               | 29,<br>2012    | February 28,<br>2011 | February<br>29,<br>2012   | February 28,<br>2011 | 29,<br>2012  | February<br>28,<br>2011 |
| (dollar amounts in thousands) | Average volume |                      | Interest income           |                      | Average rate |                         |
| Long-term fixed-rate loans    | \$ 16,435,218  | \$ 16,163,100        | \$ 662,135                | \$ 676,484           | 5.38%        | 5.60%                   |
| Long-term variable-rate loans | 626,620        | 923,720              | 18,104                    | 34,642               | 3.86         | 5.01                    |
| Line of credit loans          | 1,083,255      | 1,441,282            | 23,607                    | 33,477               | 2.91         | 3.11                    |
| Restructured loans            | 463,434        | 491,193              | 10,537                    | 2,096                | 3.04         | 0.57                    |
| Non-performing loans          | 39,398         | 315,184              | -                         | 149                  | -            | 0.06                    |
| Total                         | 18,647,925     | 19,334,479           | 714,383                   | 746,848              | 5.12         | 5.16                    |
| Investments                   | 466,685        | 367,460              | 3,086                     | 3,001                | 0.88         | 1.09                    |
| Fee income (1)                | -              | -                    | 5,554                     | 6,024                | -            | -                       |
| Total                         | \$ 19,114,610  | \$ 19,701,939        | \$ 723,023                | \$ 755,873           | 5.05         | 5.13                    |

(1) Primarily related to conversion fees that are deferred and recognized using the effective interest method over the remaining original loan interest rate pricing term, except for a small portion of the total fee charged to cover administrative costs related to the conversion, which is recognized immediately.



## Analysis of changes in interest income

|  | For the three months ended<br>February 29, 2012 vs. February 28, 2011 |                     |               | For the nine months ended<br>February 29, 2012 vs. February 28,<br>2011 |                     |               |
|--|---|---------------------|---------------|---|---------------------|---------------|
|  | Change due to (3)   |                     |               | Change due to (3)   |                     |               |
| (dollar amounts in thousands)              | Average<br>volume<br>(1)  | Average<br>rate (2) | Net<br>change | Average<br>volume<br>(1)  | Average<br>rate (2) | Net<br>change |
| Increase (decrease) in interest<br>income: |   |                     |               |   |                     |               |
| Long-term fixed-rate loans                 | \$ (2,082)  | \$ (8,088)          | \$ (10,170)   | \$ 12,022   | \$ (26,371)         | \$ (14,349)   |
| Long-term variable-rate loans              | (4,072)   | (2,772)             | (6,844)       | (11,120)  | (5,418)             | (16,538)      |
| Line of credit loans                       | (2,743)   | (1,168)             | (3,911)       | (8,293)   | (1,577)             | (9,870)       |
| Restructured loans                         | (31)  | 5,096               | 5,065         | (117)   | 8,558               | 8,441         |
| Non-performing loans                       | (86)  | (63)                | (149)         | (130)   | (19)                | (149)         |
| Total interest income on<br>loans          | (9,014)   | (6,995)             | (16,009)      | (7,638)   | (24,827)            | (32,465)      |
| Investments                                | 903   | (565)               | 338           | 814   | (729)               | 85            |
| Fee income                                 | -   | (613)               | (613)         | -   | (470)               | (470)         |
| Total interest income                      | \$ (8,111)  | \$ (8,173)          | \$ (16,284)   | \$ (6,824)  | \$ (26,026)         | \$ (32,850)   |

(1) Calculated using the following formula: (current period average balance – prior-year period average balance) x prior-year period average rate.

(2) Calculated using the following formula: (current period average rate – prior-year period average rate) x current period average balance.

(3) The net change attributable to the combined impact of volume and rate has been allocated to each in proportion to the absolute dollar amounts of change.

During the three months ended February 29, 2012, interest income decreased by 6 percent compared with the prior-year period primarily due to both a 5 percent decrease in average loan balances and a 10 basis point decrease in the average rate on loans. During the nine months ended February 29, 2012, interest income decreased by 4 percent compared with the prior-year period, primarily due to a 4 basis point decrease in the average rate on loans, as well as a 4 percent reduction in average loans outstanding. The lower average rate on loans during the three and nine months ended February 29, 2012 was driven by reductions to interest rates for fixed and variable-rate loans, partly offset by an increased percentage of fixed-rate loans outstanding which have a higher average rate. When you exclude the decline to the average balance of non-performing loans resulting from the completion of the transfer of control of operating entities of a non-performing borrower in October 2010, the average balance of loans that are performing decreased 2 percent for the nine months ended February 29, 2012. The decrease in average loan balances for the three and nine months ended February 29, 2012 is primarily due to the decrease in power supply loans due to the repayment of bridge loans with proceeds of RUS long-term loans and the maturity of a \$200 million RTFC loan during the nine months ended February 29, 2012.

While the total average loan balance for the nine months ended February 29, 2012 decreased, long-term fixed rate loan advances to CFC and NCSC borrowers to refinance debt from other lenders resulted in an increase to the average balance of long-term fixed-rate loans outstanding for the period. During the same time period, we have also seen large reductions to the average balance of the long-term variable rate and line of credit loan portfolios due to loan sales and repayments of bridge loans. As a result, there has been a shift in the composition of the loan portfolio to a higher concentration of fixed-rate loans. The average balance of long-term fixed-rate loans for the three months ended February 29, 2012 represented 88 percent of the total average loan balance as compared to 85 percent for the prior-year period. The average balance of long-term fixed-rate loans for the nine months ended February 29, 2012 represented 88 percent of the total average loan balance as compared to 84 percent for the prior-year period.

As a cost-based lender, we extend new loans with fixed rates based on our cost of debt at the time of the advance. As benchmark treasury rates and spreads tightened over the past 12 months, we lowered the long-term fixed rates we offered on our new loans. The average long-term fixed interest rates we offered on electric loans for the three and nine months ended February 29, 2012 decreased 153 basis points and 85 basis points, respectively, compared with the prior-year periods. Additionally, the significant amount of loans refinanced from other lenders during fiscal year 2011 have a shorter term as the borrowers generally selected a term consistent with the remaining term of their existing loan. As a result, the new fixed-rate loans were generally advanced at a rate that was lower than the weighted-average rate on the long-term fixed-rate loan portfolio at February 28, 2011. Thus, we have seen reductions of 20 basis points and 22 basis points in the weighted-average rate on our long-term fixed-rate loan portfolio during the three and nine months ended February 29, 2012, respectively, compared with the prior-year periods.

On September 1, 2011, we reduced rates on long-term variable and line of credit loans by 175 basis points and 105 basis points, respectively, resulting in a decrease in the average rate for these loans for the three and nine months ended February 29, 2012. The combination of the lower interest rates and the lower average loan balances contributed to large decreases to interest earned on long-term variable rate and line of credit loans.

On October 1, 2011, we placed a \$420 million restructured loan on accrual status. The loan to this borrower has been on non-accrual status since it was restructured in December 2002. Since that time, the borrower made all required payments in accordance with the restructure agreement, all of which have been used to reduce the outstanding principal balance. The loan balance of \$420 million was below the amount of the prepayment option in the restructure agreement, thus there would no longer be a loss recorded if the borrower were to exercise the prepayment option. The accrual rate for the loan of 4.85 percent is based on the effective interest rate returned by the remaining scheduled cash flows through December 2037. Placing this loan on accrual status caused an increase of \$5 million and \$8 million to interest income and, therefore, a higher average rate on restructured loans for both the three and nine months ended February 29, 2012, respectively, as compared to the prior-year periods.

Our non-performing and restructured loans on non-accrual status affect interest income for both the current and prior-year periods. The effect of non-accrual loans on interest income is included in the rate variance in the table above. Interest income was reduced as follows as a result of holding loans on non-accrual status:

| (dollar amounts in thousands) | For the three months ended |                   | For the nine months ended |                   |
|-------------------------------|----------------------------|-------------------|---------------------------|-------------------|
|                               | February 29, 2012          | February 28, 2011 | February 29, 2012         | February 28, 2011 |
| Electric                      | \$ 280                     | \$ 5,827          | \$ 7,641                  | \$ 17,928         |
| Telecommunications            | 164                        | -                 | 322                       | 7,404             |
| Total                         | \$ 444                     | \$ 5,827          | \$ 7,963                  | \$ 25,332         |

The decrease in interest foregone for telecommunications loans on non-accrual status was due to the reduction of non-accrual loans to Innovative Communication Corporation (“ICC”) as a result of the transfer of control of ICC’s operating entities to CAH in October 2010 and March 2011. The decrease in interest foregone for electric loans on non-accrual status is the result of moving a \$420 million restructured loan to accrual status on October 1, 2011. During the three and nine months ended February 28, 2011, the decrease to interest income from holding this borrower’s loans on non-accrual status was fully offset by the reduction to the calculated impairment due to applying all payments received against the principal balance. The reduction to the calculated impairment resulted in the recognition of income from the recovery of the loan loss allowance.

### Interest Expense

The following tables break out the average cost of debt and the change to interest expense due to changes in average debt volume versus changes to interest rates summarized by debt type. We do not fund each individual loan with specific debt. Rather, we attempt to minimize costs and maximize efficiency by funding large aggregated amounts of loans. The following tables also break out the change to derivative cash settlements due to changes in the average notional amount of our derivative portfolio versus changes to the net difference between the average rate paid and the average rate received. Additionally, the tables present adjusted interest expense, which includes all derivative cash settlements in interest expense. See Non-GAAP Financial Measures for further explanation of the adjustment we make in our financial analysis to include all derivative cash settlements in interest expense.

#### Average balances and interest rates – Liabilities

|   | For the three months ended, |                         |                         |                         |                         |                         |
|---|-----------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
|   | February<br>29,<br>2012     | February<br>28,<br>2011 | February<br>29,<br>2012 | February<br>28,<br>2011 | February<br>29,<br>2012 | February<br>28,<br>2011 |
| (dollar amounts in thousands)               | Average volume              |                         | Interest expense        |                         | Average cost            |                         |
| Commercial paper and bank bid notes (1) (2) | \$ 3,206,209                | \$ 2,917,994            | \$ (1,298)              | \$ (2,574)              | (0.16)%                 | (0.36)%                 |
| Medium-term notes (1)                       | 3,115,418                   | 3,677,125               | (44,954)                | (57,290)                | (5.80)                  | (6.32)                  |
| Collateral trust bonds (1)                  | 5,777,687                   | 5,261,149               | (78,587)                | (75,223)                | (5.47)                  | (5.80)                  |
| Subordinated deferrable debt (1)            | 180,970                     | 195,061                 | (2,806)                 | (2,806)                 | (6.24)                  | (5.83)                  |
| Subordinated certificates (1)               | 1,700,173                   | 1,812,654               | (20,052)                | (20,547)                | (4.74)                  | (4.60)                  |
| Long-term notes payable (1)                 | 4,560,336                   | 4,775,007               | (38,024)                | (42,411)                | (3.35)                  | (3.60)                  |
| Total                                       | 18,540,793                  | 18,638,990              | (185,721)               | (200,851)               | (4.03)                  | (4.37)                  |
| Debt issuance costs (3)                     | -                           | -                       | (2,128)                 | (2,604)                 | -                       | -                       |
| Fee expense (4)                             | -                           | -                       | (2,445)                 | (2,878)                 | -                       | -                       |
| Total                                       | \$ 18,540,793               | \$ 18,638,990           | \$ (190,294)            | \$ (206,333)            | (4.13)                  | (4.49)                  |
| Derivative cash settlements (5)             | \$ 9,979,399                | \$ 11,149,986           | \$ 531                  | \$ (850)                | 0.02%                   | (0.03)%                 |

|                               |            |            |           |           |        |        |
|-------------------------------|------------|------------|-----------|-----------|--------|--------|
| Adjusted interest expense (6) | 18,540,793 | 18,638,990 | (189,763) | (207,183) | (4.12) | (4.51) |
|-------------------------------|------------|------------|-----------|-----------|--------|--------|

## Average balances and interest rates – Liabilities

|   | For the nine months ended, |                   |                   |                   |                   |                   |
|---|----------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
|   | February 29, 2012          | February 28, 2011 | February 29, 2012 | February 28, 2011 | February 29, 2012 | February 28, 2011 |
| (dollar amounts in thousands)               | Average volume             |                   | Interest expense  |                   | Average cost      |                   |
| Commercial paper and bank bid notes (1) (2) | \$ 2,937,871               | \$ 2,713,693      | \$ (4,458)        | \$ (6,583)        | (0.20)%           | (0.32)%           |
| Medium-term notes (1)                       | 3,333,395                  | 3,947,526         | (146,528)         | (181,490)         | (5.87)            | (6.15)            |
| Collateral trust bonds (1)                  | 5,617,787                  | 5,154,968         | (233,205)         | (229,019)         | (5.55)            | (5.94)            |
| Subordinated deferrable debt (1)            | 180,956                    | 226,368           | (8,419)           | (10,552)          | (6.21)            | (6.23)            |
| Subordinated certificates (1)               | 1,731,122                  | 1,778,006         | (58,428)          | (61,071)          | (4.51)            | (4.59)            |
| Long-term notes payable (1)                 | 4,505,575                  | 4,692,153         | (116,922)         | (134,035)         | (3.47)            | (3.82)            |
| Total                                       | 18,306,706                 | 18,512,714        | (567,960)         | (622,750)         | (4.14)            | (4.50)            |
| Debt issuance costs (3)                     | -                          | -                 | (9,633)           | (7,722)           | -                 | -                 |
| Fee expense (4)                             | -                          | -                 | (9,425)           | (7,774)           | -                 | -                 |
| Total                                       | \$ 18,306,706              | \$ 18,512,714     | \$ (587,018)      | \$ (638,246)      | (4.28)            | (4.61)            |
| Derivative cash settlements (5)             | \$ 10,499,375              | \$ 11,218,341     | \$ (283)          | \$ (5,685)        | (0.01)%           | (0.07)%           |
| Adjusted interest expense (6)               | 18,306,706                 | 18,512,714        | (587,301)         | (643,931)         | (4.29)            | (4.65)            |

- (1) Interest expense includes the amortization of discounts on debt.
- (2) Average volume includes the daily liquidity fund.
- (3) Interest expense includes amortization of all deferred charges related to debt issuances, principally underwriter's fees, legal fees, printing costs and comfort letter fees. Amortization is calculated on the effective interest method. Also includes issuance costs related to dealer commercial paper, which are recognized as incurred.
- (4) Interest expense includes various fees related to funding activities, including fees paid to banks participating in our revolving credit agreements. Fees are recognized as incurred or amortized on a straight-line basis over the life of the respective agreement.
- (5) For derivative cash settlements, average volume represents the average notional amount of derivative contracts outstanding, and the average cost represents the net difference between the average rate paid and the average rate received for cash settlements during the period.
- (6) See Non-GAAP Financial Measures for further explanation of the adjustment we make in our financial analysis to include the derivative cash settlements in interest expense.

## Analysis of changes in interest expense

| (dollar amounts in thousands)<br>(Increase) decrease in interest<br>expense: | For the three months ended<br>February 29, 2012 vs. February 28,<br>2011 |                     |               | For the nine months ended<br>February 29, 2012 vs. February 28,<br>2011 |                     |               |
|--|--|---------------------|---------------|---|---------------------|---------------|
|  | Change due to (3)  |                     |               | Change due to (3)   |                     |               |
|  | Average<br>volume<br>(1)   | Average<br>rate (2) | Net<br>change | Average<br>volume<br>(1)  | Average<br>rate (2) | Net<br>change |
| Commercial paper and bank bid<br>notes                                       | \$ (278)   | \$ 1,554            | \$ 1,276      | \$ (551)  | \$ 2,676            | \$ 2,125      |
| Medium-term notes  | 8,346  | 3,990               | 12,336        | 28,094  | 6,868               | 34,962        |
| Collateral trust bonds   | (8,075)  | 4,711               | (3,364)       | (20,791)  | 16,605              | (4,186)       |
| Subordinated deferrable debt   | 181  | (181)               | -             | 2,109   | 24                  | 2,133         |
| Subordinated certificates  | 1,114  | (619)               | 495           | 1,556   | 1,087               | 2,643         |
| Long-term notes payable  | 1,569  | 2,818               | 4,387         | 5,211   | 11,902              | 17,113        |
| Total interest expense on debt   | 2,857  | 12,273              | 15,130        | 15,628  | 39,162              | 54,790        |
| Debt issuance costs  | -  | 476                 | 476           | -   | (1,911)             | (1,911)       |
| Fee expense  | -  | 433                 | 433           | -   | (1,651)             | (1,651)       |
| Total interest expense   | \$ 2,857   | \$ 13,182           | \$ 16,039     | \$ 15,628   | \$ 35,600           | \$ 51,228     |
| Derivative cash settlements (4)  | \$ 83  | \$ 1,298            | \$ 1,381      | \$ 359  | \$ 5,043            | \$ 5,402      |
| Adjusted interest<br>expense (5)   | 2,940  | 14,480              | 17,420        | 15,987  | 40,643              | 56,630        |

(1) Calculated using the following formula: (current period average balance – prior-year period average balance) x prior-year period average rate.

(2) Calculated using the following formula: (current period average rate – prior-year period average rate) x current period average balance.

(3) The net change attributable to the combined impact of volume and rate has been allocated to each in proportion to the absolute dollar amounts of change.

(4) For derivative cash settlements, variance due to average volume represents the change in derivative cash settlements that resulted from the change in the average notional amount of derivative contracts outstanding. Variance due to average rate represents the change in derivative cash settlements that resulted from the net difference between the average rate paid and the average rate received for interest rate swaps during the period.

(5) See Non-GAAP Financial Measures for further explanation of the adjustment we make in our financial analysis to include the derivative cash settlements in interest expense.

During the three and nine months ended February 29, 2012, interest expense decreased by 8 percent compared to the same prior-year periods primarily due to a lower average cost on our debt outstanding and, to a lesser extent, to a 1 percent lower average balance of debt outstanding. For the three and nine months ended February 29, 2012, our average cost of debt outstanding decreased by 36 basis points and 33 basis points, respectively, compared to the same prior-year periods. In November 2010, we issued collateral trust bonds at an average interest rate of 1.54 percent in order to refinance maturing collateral trust bonds with a fixed rate of 4.375 percent and to redeem subordinated deferrable debt with a fixed rate of 6.75 percent. In addition, the rate on \$750 million of long-term notes payable was reset in January 2011 at an average effective rate of 1.73 percent compared with the previous average effective rate of 5.20 percent. Both of these items continue to contribute to a decrease in our interest expense in fiscal year 2012.

For the three and nine months ended February 29, 2012, the change in the funding mix of debt outstanding compared to the prior-year periods resulted in a decrease to interest expense which is reflected in the volume column in the table above. In August 2011 and October 2011, we redeemed a total of \$500 million of 7.25 percent medium-term notes due March 1, 2012. As a result of these early redemptions, we have decreased the utilization of medium-term notes in our total funding mix for the three and nine months ended February 29, 2012 to 17 percent and 18 percent, respectively, from 20 percent and 21 percent for the prior-year periods, respectively. The decrease in medium-term notes was offset by an increase in the average balance of collateral trust bonds and commercial paper during the three and nine months ended February 29, 2012. For the three and nine months ended February 29, 2012, both the average cost of collateral trust bonds of 5.47 percent and 5.55 percent, respectively, and the average cost of commercial paper of 0.16 percent and 0.20 percent, respectively, are lower as compared to the medium-term notes average cost of 5.80 percent and 5.87 percent, respectively.

The adjusted interest expense, which includes all derivative cash settlements, was \$190 million and \$587 million for the three and nine months ended February 29, 2012, compared with \$207 million and \$644 million for the three and nine months ended February 28, 2011, respectively. The adjusted interest expense was lower during the three and nine months ended February 29, 2012 due to the lower interest expense noted above combined with a decrease in the derivative cash settlements expense discussed further below. See Non-GAAP Financial Measures for further explanation of the adjustment we make in our financial analysis to include all derivative cash settlements in interest expense.

#### Net Interest Income

The following tables represent a summary of the effect on net interest income and adjusted net interest income from changes in the components of total interest income and total interest expense described above. The following tables also summarize the net yield and adjusted net yield and the changes to net interest income and adjusted net interest income due to changes in average balances versus changes to average rate/cost.

#### Average interest rates – Assets and Liabilities

|   | For the three months ended |                         |                         |                         |
|---|----------------------------|-------------------------|-------------------------|-------------------------|
|   | February<br>29,<br>2012    | February<br>28,<br>2011 | February<br>29,<br>2012 | February<br>28,<br>2011 |
| (dollar amounts in thousands)                       | Interest income (expense)  |                         | Average rate (cost)     |                         |
| Total interest income                               | \$ 238,018                 | \$ 254,302              | 5.00%                   | 5.18%                   |
| Total interest expense                              | (190,294)                  | (206,333)               | (4.13)                  | (4.49)                  |
| Net interest income/Net yield                       | \$ 47,724                  | \$ 47,969               | 0.87%                   | 0.69%                   |
| Derivative cash settlements                         | 531                        | (850)                   | 0.02                    | (0.03)                  |
| Adjusted net interest income/Adjusted net yield (1) | \$ 48,255                  | \$ 47,119               | 0.88                    | 0.67                    |

#### Average interest rates – Assets and Liabilities

|   | For the nine months ended |                         |                         |                      |
|---|---------------------------|-------------------------|-------------------------|----------------------|
|   | February<br>29,<br>2012   | February<br>28,<br>2011 | February<br>29,<br>2012 | February 28,<br>2011 |
| (dollar amounts in thousands)                       | Interest income (expense) |                         | Average rate (cost)     |                      |
| Total interest income                               | \$ 723,023                | \$ 755,873              | 5.05%                   | 5.13%                |
| Total interest expense                              | (587,018)                 | (638,246)               | (4.28)                  | (4.61)               |
| Net interest income/Net yield                       | \$ 136,005                | \$ 117,627              | 0.77%                   | 0.52%                |
| Derivative cash settlements                         | (283)                     | (5,685)                 | (0.01)                  | (0.07)               |
| Adjusted net interest income/Adjusted net yield (1) | \$ 135,722                | \$ 111,942              | 0.76                    | 0.48                 |

(1) See Non-GAAP Financial Measures for further explanation of the adjustment we make in our financial analysis to include the derivative cash settlements in interest expense, which affects adjusted net interest income.

#### Analysis of changes in net interest income



|   | For the three months ended<br>February 29, 2012 vs. February 28,<br>2011 |                     |               | For the nine months ended<br>February 29, 2012 vs. February<br>28, 2011 |                        |               |
|---|--|---------------------|---------------|---|------------------------|---------------|
|   | Change due to (3)  |                     |               | Change due to (3)   |                        |               |
| (dollar amounts in<br>thousands)              | Average<br>volume<br>(1)   | Average<br>rate (2) | Net<br>change | Average<br>volume<br>(1)  | Average<br>rate<br>(2) | Net<br>change |
| (Decrease) increase in net<br>interest income | \$ (5,254)   | \$ 5,009            | \$ (245)      | \$ 8,804  | \$ 9,574               | \$ 18,378     |
| Increase in adjusted net interest income      | (5,171)  | 6,307               | 1,136         | 9,163   | 14,617                 | 23,780        |

(1) Calculated using the following formula: (current period average balance – prior-year period average balance) x prior-year period average rate.

(2) Calculated using the following formula: (current period average rate – prior-year period average rate) x current period average balance.

(3) The net change attributable to the combined impact of volume and rate has been allocated to each in proportion to the absolute dollar amounts of change.

Net interest income for the nine months ended February 29, 2012 increased 16 percent compared to the prior-year period while the net interest income for the three months ended February 29, 2012 remained flat compared to the prior-year period. The increase to the net interest income for the nine months ended February 29, 2012 was primarily due to the reduction to interest expense that exceeded the decrease in interest income. The primary factor driving the reduction to interest expense was our refinancing of maturing term debt and the scheduled reset of interest rates on term debt during the final three quarters of fiscal year 2011. We also decreased the utilization of medium-term notes in our overall funding mix compared with the prior-year periods and maintained a higher average balance of collateral trust bonds and commercial paper during the three and nine months ended February 29, 2012 which have a lower weighted-average cost. Interest income for the three and nine months ended February 29, 2012 decreased 6 percent and 4 percent, respectively, compared with the prior-year periods due to

a large amount of fixed-rate loan advances at rates that were lower than the weighted-average rate on the long-term fixed-rate loan portfolio at February 28, 2011 and a reduction in variable interest rates. The decrease in interest income was partly offset by placing a \$420 million restructured loan on accrual status on October 1, 2011. During the three months ended February 29, 2012, the decrease in interest expense was less than the reduction to interest income described above primarily due to prefunding \$1 billion of medium-term notes prior to the maturity date of March 1, 2012.

The adjusted net interest income increased 2 percent and 21 percent, respectively, for the three and nine months ended February 29, 2012 compared with the prior-year periods primarily due to the reduction to interest expense that exceeded the decrease in interest income in addition to lower cash settlements expense compared with the prior-year periods. During the nine months ended February 28, 2011, cash settlements expense includes a \$3 million fee we paid to terminate an interest rate swap that was match funding loans that were prepaid during the period. See Non-GAAP Financial Measures for further explanation of the adjustment we make in our financial analysis to include all derivative cash settlements in determining our adjusted interest expense which, in turn, affects adjusted net interest income.

#### (Provision for) Recovery of Loan Losses

The provision for loan losses during the three months ended February 29, 2012 was less than \$1 million compared to a \$3 million recovery during the prior-year period. The loan loss recovery of \$12 million during the nine months ended February 29, 2012 represented a reduction of \$31 million from the prior year period. The loan loss recovery of \$12 million for the nine months ended February 29, 2012 was due to reductions in the allowance for loan losses held for the impaired loan portfolio of \$14 million, partially offset by the increase in the allowance for loan losses held in the general portfolio of \$2 million. The \$14 million reduction to the loan loss allowance for impaired loans for the nine months ended February 29, 2012 was mainly due to a reduction to the long-term variable and line of credit interest rates and principal repayments on impaired loans that resulted in a recovery from the loan loss reserve of \$16 million. The recovery for impaired loans during the nine months ended February 29, 2012 was partly offset by a \$2 million increase in the reserve due to the classification of certain telecommunications loans as impaired during the period. The increase of \$2 million in the reserve for the general portfolio during the nine months ended February 29, 2012 was driven primarily by a slight deterioration in certain borrowers' internal risk rating partially offset by loan repayments and the reclassification of certain telecommunications loans from the general portfolio to impaired loans. The loan loss recovery of \$43 million for the nine months ended February 28, 2011 was due to the reduction to the amount of reserves required to write off the uncollected loan balance related to the transfer of control of the operating telecommunications and cable entities located in the US Virgin Islands as part of the settlement of a bankruptcy claim.

#### Non-interest Income

Non-interest income for the three and nine months ended February 29, 2012 decreased by \$118 million and \$266 million, respectively, compared with the same prior-year periods primarily due to increases in derivative losses of \$79 million and \$207 million, respectively, and an increase in the loss on foreclosed asset operations of \$40 million and \$53 million, respectively. The increase to the loss on the operations of foreclosed assets was due to impairment charges for goodwill and other assets related to CAH's telecommunications and cable television operations totaling \$45 million recorded during the quarter ended February 29, 2012. During the three months ended February 29, 2012, we conducted an assessment of goodwill impairment related to CAH due to regional events and market information that became available, including the recent closure of a major oil refinery, staff terminations by the local territorial government offices, all resulting in the direct loss of approximately 3,000 jobs, as well as weakening overall economic conditions in the region. We recorded a goodwill impairment charge of \$36 million and other asset impairment charges in the amount of \$9 million at CAH for the quarter ended February 29, 2012.



The derivative losses line item includes income and losses recorded for our interest rate swaps as summarized below:

| (dollar amounts in thousands) | For the three months ended |                   |             | For the nine months ended |                   |              |
|-------------------------------|----------------------------|-------------------|-------------|---------------------------|-------------------|--------------|
|                               | February 29, 2012          | February 28, 2011 | Net Change  | February 29, 2012         | February 28, 2011 | Net Change   |
| Derivative cash settlements   | \$ 531                     | \$ (850)          | \$ 1,381    | \$ (283)                  | \$ (5,685)        | \$ 5,402     |
| Derivative forward value      | (26,094)                   | 54,198            | (80,292)    | (184,604)                 | 28,090            | (212,694)    |
| Derivative (losses) gains     | \$ (25,563)                | \$ 53,348         | \$ (78,911) | \$ (184,887)              | \$ 22,405         | \$ (207,292) |

We currently use two types of interest rate exchange agreements: (i) we pay a fixed rate and receive a variable rate and (ii) we pay a variable rate and receive a fixed rate. The following chart provides a breakout of the average notional amount outstanding by type of interest rate exchange agreement and the weighted average interest rate paid and received for cash settlements:

| (dollar amounts in thousands) | For the three months ended |                            |                                | For the nine months ended |                            |                                |
|-------------------------------|----------------------------|----------------------------|--------------------------------|---------------------------|----------------------------|--------------------------------|
|                               | February 29, 2012          | February 28, 2011          | Net Change                     | February 29, 2012         | February 28, 2011          | Net Change                     |
|                               | Average notional balance   | Weighted-average rate paid | Weighted-average rate received | Average notional balance  | Weighted-average rate paid | Weighted-average rate received |
| Pay fixed-receive variable    | \$ 5,276,860               | 3.88%                      | 0.50%                          | \$ 5,762,435              | 4.13%                      | 0.29%                          |
| Pay variable-receive fixed    | 4,702,539                  | 1.52                       | 5.40                           | 5,387,551                 | 1.19                       | 5.23                           |
| Total                         | \$ 9,979,399               | 2.77                       | 2.81                           | \$ 11,149,986             | 2.70                       | 2.69                           |

| (dollar amounts in thousands) | For the three months ended |                            |                                | For the nine months ended |                            |                                |
|-------------------------------|----------------------------|----------------------------|--------------------------------|---------------------------|----------------------------|--------------------------------|
|                               | February 29, 2012          | February 28, 2011          | Net Change                     | February 29, 2012         | February 28, 2011          | Net Change                     |
|                               | Average notional balance   | Weighted-average rate paid | Weighted-average rate received | Average notional balance  | Weighted-average rate paid | Weighted-average rate received |
| Pay fixed-receive variable    | \$ 5,491,183               | 3.97%                      | 0.36%                          | \$ 5,720,930              | 4.27%                      | 0.35%                          |
| Pay variable-receive fixed    | 5,008,192                  | 1.31                       | 5.30                           | 5,497,411                 | 1.23                       | 5.23                           |
| Total                         | \$ 10,499,375              | 2.70                       | 2.72                           | \$ 11,218,341             | 2.78                       | 2.75                           |

During the three and nine months ended February 29, 2012, the net weighted-average rate we received on our interest rate swap agreements was 0.04 percent and 0.02 percent, respectively, whereas we paid a net weighted-average rate of 0.01 percent and 0.03 percent during the prior-year periods. The primary reason for the decrease in the

weighted-average outflow was the decrease to the weighted-average rate we paid on pay fixed-receive variable interest rate swaps. The lower payment for pay fixed-receive variable swaps was driven by the maturity of these swaps since February 28, 2011 that carried a higher fixed rate, as well as the addition of new pay fixed-receive variable swaps with a lower fixed rate compared with swaps in place during the prior-year period.

The derivative forward value represents the change in fair value of our interest rate swaps during the reporting period due to changes in the estimate of future interest rates over the remaining life of our derivative contracts. The derivative forward value recorded for the three and nine months ended February 29, 2012 decreased by \$80 million and \$213 million, respectively, compared with the prior-year periods. For the three and nine months ended February 29, 2012, the derivative forward value losses of \$26 million and \$185 million, respectively, were the result of decreases to the estimated yield curve for our swaps based on market expectations of interest rates of 11 basis points and 61 basis points, respectively, which caused a decrease in the fair value of pay fixed-receive variable interest rate swaps. During the nine months ended February 29, 2012, the decrease to the fair value of our pay fixed-receive variable interest rate swaps outweighed the increase in fair value for pay variable-receive fixed interest rate swaps as pay fixed-receive variable interest rate swaps represented 52 percent of our derivative contracts and they are more sensitive to changes in the estimated yield curve as they have a higher weighted-average maturity than our pay variable-receive fixed interest rate swaps. For the three months ended February 29, 2012, the fair value for pay variable-receive fixed swaps also declined in spite of the 11 basis point reduction in the estimated yield curve as a result of swap maturities and remaining tenors within the pay variable-receive fixed swap portfolio.

#### Non-interest Expense

Non-interest expense was stable for the three months ended February 29, 2012 compared to the prior-year period. The \$9 million increase to non-interest expense for the nine months ended February 29, 2012 compared with the prior-year period was primarily due to the \$12 million increase to the loss on early extinguishment of debt related to the redemption of \$500 million of medium-term notes during the period, partly offset by the lower salaries and employee benefits expense and other general and administrative expenses. The \$1 million decrease to salaries and employee benefits expense was due to

approximately \$2 million of severance expense related to the early retirement of certain qualifying employees during the nine months ended February 28, 2011. The \$4 million decrease in general and administrative expenses during the nine months ended February 29, 2012 was largely driven by lower legal fees and other expenses as a result of the completion of the transfer of control of ICC's operating entities to CAH in October 2010 and March 2011.

#### Net (Loss) Income

The change in the items described above resulted in net losses of \$37 million and \$151 million for the three and nine months ended February 29, 2012, respectively, compared with net income of \$84 million and \$132 million, respectively, for the same prior-year periods. The adjusted net loss, which excludes the effect of the derivative forward value, was \$11 million for the three months ended February 29, 2012 compared with the adjusted net income of \$29 million for the same prior-year period. The adjusted net income was \$33 million for the nine months ended February 29, 2012, compared with \$104 million, for the same prior-year period. See Non-GAAP Financial Measures for further explanation of the adjustments we make in our financial analysis to net income.

#### Net (Loss) Income Attributable to the Noncontrolling Interest

The net income or loss attributable to the noncontrolling interest represents 100 percent of the results of operations of RTFC and NCSC as the members of RTFC and NCSC own or control 100 percent of the interest in their respective companies. Noncontrolling interest for the nine months ended February 29, 2012 represents \$0.3 million of net income and \$3.5 million of net loss for RTFC and NCSC, respectively, compared with net loss of \$0.6 million and net income of \$3 million for RTFC and NCSC, respectively, for the prior-year period. Fluctuations in NCSC's net income and loss are primarily due to fluctuations in the fair value of its derivative instruments.

#### Ratio of Earnings to Fixed Charges

The following table provides the calculation of the ratio of earnings to fixed charges. The fixed-charge coverage ratio includes capitalized interest in total fixed charges, which is not included in our TIER calculation.

|  | For the three months ended |            | For the nine months ended |            |
|--|----------------------------|------------|---------------------------|------------|
|  | February                   | February   | February                  | February   |
| (dollar amounts in thousands)  | 29,                        | 28,        | 29,                       | 28,        |
|  | 2012                       | 2011       | 2012                      | 2011       |
| Net (loss) income prior to cumulative effect of                              |                            |            |                           |            |
| change in accounting principle   | \$ (37,299)                | \$ 83,652  | \$ (151,215)              | \$ 131,979 |
| Add: fixed charges   | 190,294                    | 206,388    | 587,089                   | 638,383    |
| Less: interest capitalized   | -                          | (55)       | (71)                      | (137)      |
| Earnings available for fixed charges   | \$ 152,995                 | \$ 289,985 | \$ 435,803                | \$ 770,225 |
| Total fixed charges:   |                            |            |                           |            |
| Interest on all debt (including amortization of discount and issuance costs) | \$ 190,294                 | \$ 206,333 | \$ 587,018                | \$ 638,246 |
| Interest capitalized   | -                          | 55         | 71                        | 137        |
| Total fixed charges  | \$ 190,294                 | \$ 206,388 | \$ 587,089                | \$ 638,383 |
| Ratio of earnings to fixed charges (1)                                       | -                          | 1.41       | -                         | 1.21       |

(1) For the three and nine months ended February 29, 2012, earnings were insufficient to cover fixed charges by \$37 million and \$151 million, respectively, and, therefore, the ratio for those periods result in a value below 1.00.



## Financial Condition

## Loan and Guarantee Portfolio Assessment

## Loan Programs

We are a cost-based lender that offers long-term fixed- and variable-rate loans and line of credit variable-rate loans. Borrowers choose between a variable interest rate or a fixed interest rate for periods of one to 35 years. When a selected fixed interest rate term expires, the borrower may select another fixed-rate term or the variable rate.

The following table summarizes loans outstanding by type and by member class:

| (dollar amounts in thousands) | February 29, 2012 |      | May 31, 2011  |      | Increase/<br>(decrease) |
|-------------------------------|-------------------|------|---------------|------|-------------------------|
| Loans by type (1):            | Amount            | %    | Amount        | %    |                         |
| Long-term loans:              |                   |      |               |      |                         |
| Long-term fixed-rate loans    | \$ 16,590,157     | 89%  | \$ 16,404,940 | 85%  | \$ 185,217              |
| Long-term variable-rate loans | 660,713           | 4    | 1,278,391     | 7    | (617,678)               |
| Loans guaranteed by RUS       | 220,257           | 1    | 226,695       | 1    | (6,438)                 |
| Total long-term loans         | 17,471,127        | 94   | 17,910,026    | 93   | (438,899)               |
| Line of credit loans          | 1,140,097         | 6    | 1,414,650     | 7    | (274,553)               |
| Total loans                   | \$ 18,611,224     | 100% | \$ 19,324,676 | 100% | \$ (713,452)            |

## Loans by member class (1):

## CFC:

|                         |               |      |               |      |              |
|-------------------------|---------------|------|---------------|------|--------------|
| Distribution            | \$ 13,801,204 | 74%  | \$ 13,760,228 | 71%  | \$ 40,976    |
| Power supply            | 3,572,104     | 19   | 4,092,290     | 21   | (520,186)    |
| Statewide and associate | 73,381        | 1    | 88,961        | 1    | (15,580)     |
| CFC total               | 17,446,689    | 94   | 17,941,479    | 93   | (494,790)    |
| RTFC                    | 580,205       | 3    | 859,122       | 4    | (278,917)    |
| NCSC                    | 584,330       | 3    | 524,075       | 3    | 60,255       |
| Total loans             | \$ 18,611,224 | 100% | \$ 19,324,676 | 100% | \$ (713,452) |

(1) Includes loans classified as restructured and non-performing.

The balance of loans outstanding decreased by \$713 million during the nine months ended February 29, 2012 mainly due to the \$520 million reduction to power supply loans resulting largely from the repayment of bridge loans with proceeds of long-term loans from RUS or member capital market issuances which were partially offset by new advances to power supply borrowers. There was also the maturity of a \$200 million loan to a RTFC borrower during the nine months ended February 29, 2012 which was the primary contributor to the \$279 million decrease in RTFC loans outstanding.

During the nine months ended February 29, 2012, \$1,337 million of CFC long-term fixed-rate loans were scheduled to reprice. Of this total, \$1,073 million selected a new long-term fixed rate; \$170 million selected the long-term variable rate; \$32 million selected a new rate offered as part of our loan sale program and were sold by CFC with CFC continuing to service the loans sold; and \$62 million were prepaid in full.

The following table summarizes loans and guarantees outstanding by member class:

| (dollar amounts in thousands) | February 29, 2012 |               | May 31, 2011 |               | Increase/<br>(decrease) |
|-------------------------------|-------------------|---------------|--------------|---------------|-------------------------|
|                               | Amount            | % of<br>Total | Amount       | % of<br>Total |                         |



|                            |               |      |               |      |              |
|----------------------------|---------------|------|---------------|------|--------------|
| CFC:                       |               |      |               |      |              |
| Distribution               | \$ 14,023,345 | 71%  | \$ 13,977,327 | 68%  | \$ 46,018    |
| Power supply               | 4,425,915     | 22   | 4,909,908     | 24   | (483,993)    |
| Statewide and associate    | 81,395        | 1    | 109,768       | 1    | (28,373)     |
| CFC total                  | 18,530,655    | 94   | 18,997,003    | 93   | (466,348)    |
| RTFC                       | 581,231       | 3    | 859,943       | 4    | (278,712)    |
| NCSC                       | 649,147       | 3    | 572,718       | 3    | 76,429       |
| Total loans and guarantees | \$ 19,761,033 | 100% | \$ 20,429,664 | 100% | \$ (668,631) |

#### Credit Concentration

The service territories of our electric and telecommunications members are located throughout the United States and its territories, including 49 states, the District of Columbia and two U.S. territories. At February 29, 2012 and May 31, 2011, loans outstanding to members in any one state or territory did not exceed 17 percent and 19 percent of total loans outstanding, respectively.

At February 29, 2012 and May 31, 2011, the total exposure outstanding to any one borrower or controlled group did not exceed 2.5 percent and 2.4 percent, respectively, of total loans and guarantees outstanding. At February 29, 2012, the 10 largest borrowers included five distribution systems and five power supply systems. At May 31, 2011, the 10 largest borrowers included four distribution systems and six power supply systems. The following table represents the exposure to the 10 largest borrowers as a percentage of total exposure presented by type of exposure and by company:

| (dollar amounts in thousands)                 | February 29, 2012 |            | May 31, 2011 |            | Increase/<br>(decrease) |
|---|-------------------|------------|--------------|------------|-------------------------|
|   | Amount            | % of Total | Amount       | % of Total |                         |
| Total by exposure type:                       |                   |            |              |            |                         |
| Loans   | \$ 2,963,362      | 15%        | \$ 3,206,808 | 16%        | \$ (243,446)            |
| Guarantees                                    | 374,156           | 2          | 302,771      | 1          | 71,385                  |
| Total credit exposure to 10 largest borrowers | \$ 3,337,518      | 17         | \$ 3,509,579 | 17%        | \$ (172,061)            |
| Total by company:                             |                   |            |              |            |                         |
| CFC   | \$ 3,316,268      | 17%        | \$ 3,488,329 | 17%        | \$ (172,061)            |
| NCSC  | 21,250            | -          | 21,250       | -          | -                       |
| Total credit exposure to 10 largest borrowers | \$ 3,337,518      | 17         | \$ 3,509,579 | 17%        | \$ (172,061)            |

#### Security Provisions

The following table summarizes our unsecured credit exposure as a percentage of total exposure presented by type of exposure and by company:

| (dollar amounts in thousands)   | February 29, 2012 |            | May 31, 2011 |            | Increase/<br>(decrease) |
|---------------------------------|-------------------|------------|--------------|------------|-------------------------|
|                                 | Amount            | % of Total | Amount       | % of Total |                         |
| Total by exposure type:         |                   |            |              |            |                         |
| Loans                           | \$ 1,596,656      | 8%         | \$ 2,200,140 | 11%        | \$ (603,484)            |
| Guarantees                      | 369,464           | 2          | 281,431      | 1          | 88,033                  |
| Total unsecured credit exposure | \$ 1,966,120      | 10%        | \$ 2,481,571 | 12%        | \$ (515,451)            |
| Total by company:               |                   |            |              |            |                         |
| CFC                             | \$ 1,739,905      | 9%         | \$ 2,041,440 | 10%        | \$ (301,535)            |
| RTFC                            | 25,285            | -          | 231,923      | 1          | (206,638)               |
| NCSC                            | 200,930           | 1          | 208,208      | 1          | (7,278)                 |
| Total unsecured credit exposure | \$ 1,966,120      | 10%        | \$ 2,481,571 | 12%        | \$ (515,451)            |

#### Pledged Loans and Loans on Deposit

The following table summarizes our secured debt or debt requiring collateral on deposit, the excess collateral pledged and our unencumbered loans:

| (dollar amounts in thousands)                                    | February 29,<br>2012        | May 31,<br>2011             |
|--|-----------------------------|-----------------------------|
| Total loans to members   | \$ 18,611,224               | \$ 19,324,676               |
| Less: Total secured debt or debt requiring collateral on deposit | (10,904,287)<br>(1,429,746) | (10,111,094)<br>(1,668,457) |



## Non-performing and Restructured Loans

The following table presents a summary of non-performing and restructured loans as a percentage of total loans and total loans and guarantees outstanding:

| (dollar amounts in thousands)               | February 29,<br>2012 | May 31,<br>2011 |
|---|----------------------|-----------------|
| Non-performing loans (1)                    | \$ 41,936            | \$ 31,344       |
| Percent of loans outstanding                | 0.23%                | 0.16%           |
| Percent of loans and guarantees outstanding | 0.21                 | 0.15            |
| <br>  |                      |                 |
| Restructured loans                          | \$ 457,838           | \$ 474,381      |
| Percent of loans outstanding                | 2.46%                | 2.45%           |
| Percent of loans and guarantees outstanding | 2.32                 | 2.32            |
| <br>  |                      |                 |
| Total non-performing and restructured loans | \$ 499,774           | \$ 505,725      |
| Percent of loans outstanding                | 2.69%                | 2.61%           |
| Percent of loans and guarantees outstanding | 2.53                 | 2.47            |
| <br>  |                      |                 |
| Total non-accrual loans                     | \$ 41,936            | \$ 465,312      |
| Percent of loans outstanding                | 0.23%                | 2.41%           |
| Percent of loans and guarantees outstanding | 0.21                 | 2.28            |

(1) All loans classified as non-performing were on non-accrual status.

At February 29, 2012 and May 31, 2011, non-performing loans included \$30 million and \$31 million, respectively, of loans to an electric distribution cooperative that undertook a project to develop a geothermal electric generating facility. This borrower filed for bankruptcy in September 2010. The borrower filed a disclosure statement with the bankruptcy court that contained a preliminary draft of a reorganization plan for creditors and other parties of interest to review. The bankruptcy court has set June 29, 2012 as the deadline for the borrower to file a revised draft plan of reorganization, which is expected to be subject to further revisions, hearings and rulings before approval.

At February 29, 2012, non-performing loans also included a total of \$7 million to two telecommunications borrowers and \$5 million to one electric power supply borrower for which we do not expect to collect all principal and interest payments as scheduled by the original terms. These non-performing loans were put on non-accrual status during the first quarter of fiscal year 2012 for the telecommunications borrowers and during the second quarter of fiscal year 2012 for the electric borrower.

At February 29, 2012 and May 31, 2011, we had restructured loans totaling \$458 million and \$474 million, respectively, all of which were performing according to their restructured terms. Approximately \$6 million and \$11 million of interest income was accrued on restructured loans during the three and nine months ended February 29, 2012, respectively, compared with \$1 million and \$2 million of interest income in the same prior-year periods. At May 31, 2011, we had a \$434 million restructured loan on nonaccrual status to a large electric distribution cooperative. The loan to this borrower has been on non-accrual status since it was restructured in December 2002. Since that time, the borrower made all required payments in accordance with the restructure agreement, all of which have been used to reduce the outstanding principal balance. On October 1, 2011, the loan balance of \$420 million was below the amount of the prepayment option in the restructure agreement, thus there would no longer be a loss recorded if the borrower were to exercise the prepayment option and the loan was placed on accrual status. The accrual rate for the loan of 4.85 percent is based on the effective interest rate returned by the remaining scheduled cash flows through December 2037. At February 29, 2012, all restructured loans were on accrual status with respect to the

recognition of interest income.

## Allowance for Loan Losses

We maintain an allowance for loan losses at a level estimated by management to provide adequately for probable losses inherent in the loan portfolio. Activity in the allowance for loan losses is summarized below including a disaggregation by company of the allowance for loan losses held at CFC:

| (dollar amounts in thousands)                                | As of and for the<br>three months ended |                         | As of and for the<br>nine months ended |                         | As of and<br>for<br>the year<br>ended |
|--|---|-------------------------|--|-------------------------|---------------------------------------|
|  | February 29,<br>2012                    | February<br>28,<br>2011 | February<br>29,<br>2012                | February<br>28,<br>2011 | May 31,<br>2011                       |
| Beginning balance  | \$ 149,158                              | \$ 225,546              | \$ 161,177                             | \$ 592,764              | \$ 592,764                            |
| Provision for (recovery of)<br>loan losses                   | 263                                     | (3,374)                 | (11,862)                               | (42,915)                | (83,010)                              |
| Net recovery (charge-off)                                    | 53                                      | 52                      | 159                                    | (327,625)               | (348,577)                             |
| Ending balance   | \$ 149,474                              | \$ 222,224              | \$ 149,474                             | \$ 222,224              | \$ 161,177                            |
| Loan loss allowance by segment:                              |   |                         |  |                         |                                       |
| CFC (1)  |   |                         | \$ 132,269                             | \$ 159,307              | \$ 143,706                            |
| RTFC (1)   |   |                         | 8,559                                  | 53,713                  | 8,389                                 |
| NCSC (1)   |   |                         | 8,646                                  | 9,204                   | 9,082                                 |
| Total  |   |                         | \$ 149,474                             | \$ 222,224              | \$ 161,177                            |
| As a percentage of total<br>loans outstanding                |   |                         | 0.80%                                  | 1.14%                   | 0.84%                                 |
| As a percentage of total non-performing loans<br>outstanding |   |                         | 356.43                                 | 238.02                  | 514.22                                |
| As a percentage of total restructured loans outstanding      |   |                         | 32.65                                  | 46.14                   | 33.98                                 |
| As a percentage of total loans on<br>non-accrual             |   |                         | 356.43                                 | 41.58                   | 34.64                                 |

(1) The allowance for loan losses recorded for RTFC and NCSC are held at CFC with the exception of the NCSC loan loss allowance of \$2 thousand at February 28, 2011 to cover the exposure for consumer loans. The balance of NCSC's consumer loans was reduced to zero at May 31, 2011.

Our loan loss allowance decreased by \$12 million from May 31, 2011 to February 29, 2012 due to reductions in the allowance for loan losses held for the impaired loan portfolio of \$14 million partially offset by the \$2 million increase in the allowance for loan losses held for the general portfolio. See (Provision for) Recovery of Loan Losses in the Results of Operations section for further discussion. On a quarterly basis, we review all non-performing and restructured borrowers, as well as certain additional borrowers selected based on known facts and circumstances, to determine if the loans to the borrower are impaired and/or to determine if there are changes to a previously-impaired loan. We calculate a borrower's impairment based on the expected future cash flows or the fair value of the collateral securing our loans to the borrower if cash flow cannot be estimated. As events related to the borrower take place and economic conditions and our assumptions change, the impairment calculations will change. At February 29, 2012 and May 31, 2011, there was a total specific loan loss allowance balance of \$23 million and \$37 million, respectively, related to impaired loans totaling \$500 million and \$506 million, respectively.

#### Liabilities and Equity

##### Outstanding Debt

The following table breaks out our debt outstanding by type of debt:

| (dollar amounts in thousands)                           | February 29,<br>2012 | May 31,<br>2011 | Increase/<br>decrease |
|---|----------------------|-----------------|-----------------------|
| Commercial paper sold through dealers, net of discounts | \$ 1,626,618         | \$ 1,471,715    | \$ 154,903            |
| Commercial paper sold directly to members, at par       | 978,641              | 1,189,770       | (211,129)             |
| Commercial paper sold directly to non-members, at par   | 64,236               | 55,160          | 9,076                 |
| Daily liquidity fund                                    | 435,998              | 308,725         | 127,273               |
| Bank bid notes  | 295,000              | 295,000         | -                     |
| Collateral trust bonds                                  | 6,306,969            | 5,513,235       | 793,734               |
| Notes payable   | 4,628,782            | 4,633,854       | (5,072)               |
| Medium-term notes                                       | 3,172,442            | 3,656,274       | (483,832)             |
| Subordinated deferrable debt                            | 186,440              | 186,440         | -                     |
| Membership certificates                                 | 646,161              | 646,161         | -                     |
| Loan and guarantee certificates                         | 711,999              | 769,241         | (57,242)              |
| Member capital securities                               | 398,250              | 398,250         | -                     |
| Total debt outstanding                                  | \$ 19,451,536        | \$ 19,123,825   | \$ 327,711            |
| Percentage of fixed-rate debt (1)                       | 80%                  | 79%             |                       |
| Percentage of variable-rate debt (2)                    | 20                   | 21              |                       |
| Percentage of long-term debt                            | 83%                  | 83%             |                       |
| Percentage of short-term debt                           | 17                   | 17              |                       |

(1) Includes variable-rate debt that has been swapped to a fixed rate net of any fixed-rate debt that has been swapped to a variable rate.

(2) The rate on commercial paper notes does not change once the note has been issued. However, the rates on new commercial paper notes change daily, and commercial paper notes generally have maturities of less than 90 days. Therefore, commercial paper notes are classified as variable-rate debt. Also includes fixed-rate debt that has been swapped to a variable rate net of any variable-rate debt that has been swapped to a fixed rate.

During the nine months ended February 29, 2012, total debt outstanding increased \$328 million. The increase was primarily due to the \$1,164 million increase in cash and restricted cash balances offset by the \$713 million reduction to the balance of loans outstanding. The increase in the cash balances at February 29, 2012 was due to the prefunding of the \$1 billion of medium-term notes scheduled to mature on March 1, 2012. As a result of the \$713 million decrease in loans outstanding, our funding requirements during the nine months ended February 29, 2012 were primarily related to the early redemption of \$500 million of medium-term notes scheduled to mature on March 1, 2012 and prefunding the remaining \$1 billion of medium-term notes scheduled to mature on that date. We met these funding needs primarily with scheduled loan repayments and with the issuance of collateral trust bonds in February 2012 totaling \$800 million. In February 2012, we issued \$400 million of 1.00 percent collateral trust bonds due 2015 and \$400 million of 3.05 percent collateral trust bonds due 2022.

Total commercial paper, daily liquidity fund and bid notes outstanding represented 17 percent of total debt at both February 29, 2012 and May 31, 2011. To take advantage of the current low interest rates on short-term debt, we intend to continue to maximize the use of commercial paper in our funding portfolio mix. In October 2011, we reduced the total commitment under our revolving credit lines, which will limit our ability to expand the use of commercial paper from current levels.

#### Equity

At February 29, 2012, total equity decreased by \$199 million from May 31, 2011 largely due to a net loss of \$151 million for the nine months ended February 29, 2012 and the board-authorized patronage capital retirement of \$46 million. In July 2011, the CFC Board of Directors authorized the allocation of the fiscal year 2011 net earnings as follows: \$1 million to the cooperative educational fund, \$92 million to members in the form of patronage capital and \$80 million to the members' capital reserve. In July 2011, the CFC Board of Directors authorized the retirement of allocated net earnings totaling \$46 million, representing 50 percent of the fiscal year 2011 allocation. This amount was returned to members in cash in September 2011. Future allocations and retirements of net earnings may be made annually as determined by the CFC Board of Directors with due regard for CFC's financial condition. The CFC Board of Directors has the authority to change the current practice for allocating and retiring net earnings at any time, subject to applicable cooperative law.

#### Contractual Obligations

The following table summarizes our long-term contractual obligations at February 29, 2012 and the scheduled reductions by fiscal year and thereafter:

| (dollar amounts in millions)             | Remaining contractual obligations for the years ended May 31, (1) |          |       |      |      |            |          |
|--|---|----------|-------|------|------|------------|----------|
|  | 2012  | 2013     | 2014  | 2015 | 2016 | Thereafter | Total    |
| Long-term debt due in less than one year | \$ 1,352  | \$ 1,057 | \$ -  | \$ - | \$ - | \$ -       | \$ 2,409 |
| Long-term debt                           | -   | 136      | 2,404 | 844  | 986  | 7,344      | 11,714   |
| Subordinated deferrable debt             | -   | -        | -     | -    | -    | 186        | 186      |
| Members' subordinated certificates (2)   | -   | 4        | 15    | 30   | 17   | 1,511      | 1,577    |
|  | 189   | 648      | 576   | 525  | 504  | 6,154      | 8,596    |



Contractual interest on  
long-term debt (3)

|                               |       |       |       |       |       |        |        |
|-------------------------------|-------|-------|-------|-------|-------|--------|--------|
| Total contractual obligations | \$    | \$    | \$    | \$    | \$    | \$     | \$     |
|                               | 1,541 | 1,845 | 2,995 | 1,399 | 1,507 | 15,195 | 24,482 |

(1) The table does not include contractual obligations of the entities that are included in our foreclosed assets.

(2) Excludes loan subordinated certificates totaling \$165 million that amortize annually based on the outstanding balance of the related loan. There are many items that affect the amortization of a loan, such as loan conversions, loan repricing at the end of an interest rate term and prepayments; therefore, an amortization schedule cannot be maintained for these certificates. Over the past three years, annual amortization on these certificates has averaged \$23 million. In fiscal year 2011, amortization represented 16 percent of amortizing loan subordinated certificates outstanding.

(3) Represents the interest obligation on our debt based on terms and conditions at February 29, 2012.

## Off-Balance Sheet Obligations

## Guarantees

The following table breaks out our guarantees outstanding by type of guarantee and by company:

| (dollar amounts in thousands)             | February 29,<br>2012 | May 31,<br>2011 | Increase/<br>(decrease) |
|---|----------------------|-----------------|-------------------------|
| Total by guarantee type:                  |                      |                 |                         |
| Long-term tax-exempt bonds                | \$ 573,870           | \$ 599,935      | \$ (26,065)             |
| Indemnifications of tax benefit transfers | 53,507               | 59,895          | (6,388)                 |
| Letters of credit                         | 405,310              | 327,201         | 78,109                  |
| Other guarantees                          | 117,122              | 117,957         | (835)                   |
| Total                                     | \$ 1,149,809         | \$ 1,104,988    | \$ 44,821               |
| Total by company:                         |                      |                 |                         |
| CFC                                       | \$ 1,083,966         | \$ 1,055,524    | \$ 28,442               |
| RTFC                                      | 1,026                | 821             | 205                     |
| NCSC                                      | 64,817               | 48,643          | 16,174                  |
| Total                                     | \$ 1,149,809         | \$ 1,104,988    | \$ 44,821               |

In addition to the letters of credit listed in the table, under master letters of credit facilities in place at February 29, 2012, we may be required to issue up to an additional \$793 million in letters of credit to third parties for the benefit of our members. Of this amount, \$620 million represents commitments that may be used for the issuance of letters of credit or line of credit loan advances, at the option of a borrower, and are included in unadvanced loan commitments for line of credit loans reported in Note 2, Loans and Commitments. Master letters of credit facilities subject to material adverse change clauses at the time of issuance totaled \$484 million at February 29, 2012. Prior to issuing a letter of credit, we would confirm that there has been no material adverse change in the business condition, financial or otherwise, of the borrower since the time the loan was approved and confirm that the borrower is currently in compliance with the letter of credit terms and conditions. The remaining commitment under master letters of credit facilities of \$309 million may be advanced as long as the borrower is in compliance with the terms and conditions of the facility.

At February 29, 2012 and May 31, 2011, 68 percent and 75 percent, respectively, of total guarantees were secured by a mortgage lien on substantially all of the system's assets and future revenue.

The increase in total guarantees during the nine months ended February 29, 2012 is primarily due to a net increase to the total amount of letters of credit outstanding partially offset by normal amortization of guaranteed debt. At February 29, 2012 and May 31, 2011, we recorded a guarantee liability totaling \$27 million and \$22 million, respectively, which represents the contingent and non-contingent exposure related to guarantees and liquidity obligations associated with members' debt.

The following table summarizes the off-balance sheet obligations at February 29, 2012, and the related maturities by fiscal year and thereafter as follows:

| (dollar amounts in thousands) | Outstanding balance | Remaining maturities for the years ended May 31, |            |           |            |           |            |
|-------------------------------|---------------------|--|------------|-----------|------------|-----------|------------|
|                               |                     | 2012   | 2013       | 2014      | 2015       | 2016      | Thereafter |
| Guarantees (1)                | \$ 1,149,809        | \$ 56,500  | \$ 248,381 | \$ 56,556 | \$ 188,825 | \$ 22,602 | \$ 576,945 |

(1) At February 29, 2012, we are the guarantor and liquidity provider for \$499 million of tax-exempt bonds issued for our member cooperatives. We have also issued letters of credit to provide standby liquidity for an additional \$125 million of tax-exempt bonds.

Contingent Off-Balance Sheet Obligations

Unadvanced Loan Commitments

Unadvanced commitments represent approved and executed loan contracts for which the funds have not been advanced. At February 29, 2012 and May 31, 2011, we had the following amount of unadvanced commitments on loans to our borrowers.

| (dollar amounts in thousands) | February<br>29,<br>2012 | % of<br>Total | May 31,<br>2011 | % of<br>Total |
|-------------------------------|-------------------------|---------------|-----------------|---------------|
| Long-term                     | \$ 5,430,391            | 38%           | \$ 5,461,484    | 39%           |
| Line of credit                | 8,706,593               | 62            | 8,609,191       | 61            |
| Total                         | \$ 14,136,984           | 100%          | \$ 14,070,675   | 100%          |

A total of \$1,267 million and \$999 million of unadvanced commitments at February 29, 2012 and May 31, 2011, respectively, represented unadvanced commitments related to committed lines of credit that are not subject to a material adverse change clause at the time of each advance. As such, we would be required to advance amounts on these committed facilities as long

as the borrower is in compliance with the terms and conditions of the facility. The remaining available amounts at February 29, 2012 and May 31, 2011 are conditional obligations because they are generally subject to material adverse change clauses. Prior to making an advance on these facilities, we confirm that there has been no material adverse change in the business condition, financial or otherwise, of the borrower since the time the loan was approved and confirm that the borrower is currently in compliance with loan terms and conditions.

Unadvanced commitments related to line of credit loans are typically revolving facilities for periods not to exceed five years. It is our experience that unadvanced commitments related to line of credit loans are usually not fully drawn. We believe these conditions will continue for the following reasons:

- electric cooperatives generate a significant amount of cash from the collection of revenue from their customers, so they usually do not need to draw down on loan commitments to supplement operating cash flow;
  - the majority of the line of credit unadvanced commitments provide backup liquidity to our borrowers; and
- historically, we have experienced a very low utilization rate on line of credit loan facilities, whether or not there is a material adverse change clause at the time of advance.

In our experience, unadvanced commitments related to term loans may not be fully drawn and borrowings occur in multiple transactions over an extended period of time. We believe these conditions will continue for the following reasons:

- electric cooperatives typically execute loan contracts to cover multi-year work plans and, as such, it is expected that advances on such loans will occur over a multi-year period;
- electric cooperatives generate a significant amount of cash from the collection of revenue from their customers, thus operating cash flow is available to reduce the amount of additional funding needed for capital expenditures and maintenance;
  - we generally do not charge our borrowers a fee on long-term unadvanced commitments; and
  - long-term unadvanced commitments generally expire within five years of the first advance on a loan.

Unadvanced commitments that are subject to a material adverse change clause are classified as contingent liabilities. Based on the conditions to advance funds described above, the majority of our unadvanced loan commitments do not represent off-balance sheet liabilities and have not been included with guarantees in our off-balance sheet disclosures above. We do, however, record a reserve for credit losses associated with our unadvanced commitments for committed facilities that are not subject to a material adverse change clause. The following table summarizes the available balance under committed lines of credit at February 29, 2012, and the related maturities by fiscal year and thereafter as follows:

| (dollar amounts<br>in thousands) | Available<br>balance | Remaining maturities for the years ended May 31, |            |            |           |            |            |
|----------------------------------|----------------------|--|------------|------------|-----------|------------|------------|
|                                  |                      | 2012   | 2013       | 2014       | 2015      | 2016       | Thereafter |
| Committed lines<br>of credit     | \$1,267,174          | \$ -   | \$ 151,521 | \$ 365,535 | \$ 49,975 | \$ 223,714 | \$ 476,429 |

## Ratio Analysis

### Leverage Ratio

The leverage ratio is calculated by dividing the sum of total liabilities and guarantees outstanding by total equity. Based on this formula, the leverage ratio at February 29, 2012 was 44.19-to-1, an increase from 30.52-to-1 at May 31, 2011. The increase in the leverage ratio is due to the increases of \$569 million in total liabilities and \$45 million in guarantees and the decrease of \$199 million in total equity as discussed under the Liabilities and Equity section and the Off-Balance Sheet Obligations section of Financial Condition.

For covenant compliance on our revolving credit agreements and for internal management purposes, the leverage ratio calculation is adjusted to exclude derivative liabilities, debt used to fund loans guaranteed by RUS, subordinated deferrable debt and subordinated certificates from liabilities; uses members' equity rather than total equity; and adds subordinated deferrable debt and subordinated certificates to calculate adjusted equity.

At February 29, 2012 and May 31, 2011, the adjusted leverage ratio was 6.84 to-1 and 6.48-to-1, respectively. See Non-GAAP Financial Measures for further explanation and a reconciliation of the adjustments we make to our leverage ratio calculation. The increase to the adjusted leverage ratio was due to increases of \$490 million in adjusted liabilities and \$45 million to guarantees and the decrease of \$71 million in adjusted equity as discussed under the Liabilities and Equity section and the Off-Balance Sheet Obligations section of Financial Condition.

### Debt-to-Equity Ratio

The debt-to-equity ratio is calculated by dividing the sum of total liabilities outstanding by total equity. The debt-to-equity ratio based on this formula at February 29, 2012 was 41.84 -to-1, an increase from 28.92-to-1 at May 31, 2011. The increase in the debt-to-equity ratio is due to the increase of \$569 in total liabilities and the decrease of \$199 million in total equity as discussed under the Liabilities and Equity section of Financial Condition.

For internal management purposes, the debt-to-equity ratio calculation is adjusted to exclude derivative liabilities, debt used to fund loans guaranteed by RUS, subordinated deferrable debt and subordinated certificates from liabilities; uses members' equity rather than total equity; and adds subordinated deferrable debt and subordinated certificates to determine adjusted equity. At February 29, 2012 and May 31, 2011, the adjusted debt-to-equity ratio was 6.42 -to-1 and 6.09-to-1, respectively. See Non-GAAP Financial Measures for further explanation and a reconciliation of the adjustments made to the debt-to-equity ratio calculation. The increase in the adjusted debt-to-equity ratio is due to the increase of \$490 million in adjusted liabilities and the decrease of \$71 million in adjusted equity.

### Liquidity and Capital Resources

The following section discusses our expected sources and uses of liquidity. At February 29, 2012, we expect that our current sources of liquidity will allow us to issue the debt required to fund our operations over the next 12 to 18 months.

The table below shows the projected sources and uses of cash by quarter through August 31, 2013. In analyzing our projected liquidity position, we track key items identified in the chart below. The long-term debt maturities represent the scheduled maturities of our outstanding term debt for the period presented. The long-term loan advances represent our current best estimate of the member demand for our loans, the amount and the timing of which are subject to change. The long-term loan amortization and prepayments represent the scheduled long-term loan amortization for the outstanding loans at February 29, 2012, as well as our current estimate for the prepayment of long-term loans. The estimate of the amount and timing of long-term loan prepayments is subject to change. We assumed the issuance of commercial paper, medium-term notes and other long-term debt, including collateral trust bonds and private placement of term debt, to maintain matched funding within our loan portfolio and to allow our revolving lines of credit to provide backup liquidity for our outstanding commercial paper. Commercial paper repayments in the table below do not represent scheduled maturities but rather the assumed use of excess cash to pay down the commercial paper balance.

| (dollar amounts in millions) | Projected uses of liquidity |                                 |                         |                         | Projected sources of liquidity           |                  |                                       |                   | Cumulative excess sources over uses of liquidity |                            |
|------------------------------|-----------------------------|---------------------------------|-------------------------|-------------------------|--|------------------|---------------------------------------|-------------------|--|----------------------------|
|                              | Long-term debt maturities   | Debt repayment-commercial paper | Long-term loan advances | Total uses of liquidity | Long-term loan amortization & prepayment | Commercial paper | Debt Issuance<br>Other long-term debt | Medium term notes |  | Total sources of liquidity |
| 3Q12                         |                             |                                 |                         |                         |  |                  |                                       |                   |  | \$ 1,458                   |
| 4Q12                         | \$ 1,352                    | \$ -                            | \$ 508                  | \$ 1,860                | \$ 397                                   | \$ -             | \$ 200                                | \$ 200            | \$ 797   | 395                        |
| 1Q13                         | 317                         | -                               | 559                     | 876                     | 337                                      | -                | 400                                   | 100               | 837  | 356                        |
| 2Q13                         | 419                         | -                               | 220                     | 639                     | 253                                      | -                | 300                                   | 100               | 653  | 370                        |
| 3Q13                         | 321                         | -                               | 143                     | 464                     | 433                                      | -                | -                                     | 100               | 533  | 439                        |
| 4Q13                         | 137                         | -                               | 236                     | 373                     | 259                                      | -                | -                                     | 100               | 359  | 425                        |
| 1Q14                         | 955                         | -                               | 186                     | 1,141                   | 306                                      | -                | 700                                   | 100               | 1,106  | 390                        |
| Totals                       | \$ 3,501                    | \$ -                            | \$ 1,852                | \$ 5,353                | \$ 1,985                                 | \$ -             | \$ 1,600                              | \$ 700            | \$ 4,285   |                            |

The above chart represents our best estimate of the funding requirements and how we expect to manage such funding requirements through August 31, 2013. These estimates will change on a quarterly basis based on many factors.

#### Sources of Liquidity

##### Capital Market Debt Issuance

As a well-known seasoned issuer, we have the following effective shelf registration statements on file with the U.S. Securities and Exchange Commission for the issuance of debt:

- unlimited amount of collateral trust bonds until September 2013;
- unlimited amount of medium-term notes, member capital securities and subordinated deferrable debt until November 2014; and
- daily liquidity fund for a total of \$20,000 million with a \$3,000 million limitation on the aggregate principal amount outstanding at any time until April 2013.

We issued \$175 million of eleven-month floating-rate medium-term notes and \$225 million of two-year floating-rate medium-term notes in registered offerings in December 2011 and April 2012, respectively. In February 2012, we issued \$400 million

of 1.00 percent collateral trust bonds due 2015 and \$400 million of 3.05 percent collateral trust bonds due 2022. In addition, we have a program to sell commercial paper to investors in the capital markets. We use our bank lines of credit as backup liquidity, primarily for dealer and member commercial paper. Commercial paper issued through dealers and bank bid notes totaled \$1,922 million and represented 10 percent of total debt outstanding at February 29, 2012. We intend to maintain the balance of dealer commercial paper and bank bid notes at 15 percent or less of total debt outstanding during the remainder of fiscal year 2012.

#### Private Debt Issuance

We have access to liquidity from private debt issuances through a note purchase agreement with the Federal Agricultural Mortgage Corporation. At February 29, 2012 and May 31, 2011, we had secured notes payable of \$1,411 million outstanding to the Federal Agricultural Mortgage Corporation under a note purchase agreement totaling \$3,900 million. Under the terms of our March 2011 note purchase agreement, we can borrow up to \$3,900 million at any time from the date of the agreement through January 11, 2016 and thereafter automatically extend the agreement on each anniversary date of the closing for an additional year, unless prior to any such anniversary date, the Federal Agricultural Mortgage Corporation provides CFC with a notice that the draw period will not be extended beyond the then remaining term. The agreement with the Federal Agricultural Mortgage Corporation is a revolving credit facility that allows us to borrow, repay and re-borrow funds at any time through maturity or from time to time as market conditions permit, provided that the principal amount at any time outstanding under the note purchase agreement is not more than the total available under the agreement. Each borrowing under a note purchase agreement is evidenced by a secured note setting forth the interest rate, maturity date and other related terms as we may negotiate with the Federal Agricultural Mortgage Corporation at the time of each such borrowing. We may select a fixed rate or variable rate at the time of each advance with a maturity as determined in the applicable pricing agreement. At February 29, 2012, we had up to \$2,489 million available under this agreement, subject to market conditions for debt issued by the Federal Agricultural Mortgage Corporation.

At February 29, 2012 and May 31, 2011, we had \$3,150 million of unsecured notes payable outstanding under a bond purchase agreement with the Federal Financing Bank and a bond guarantee agreement with RUS issued under the Guaranteed Underwriter program of the U.S. Department of Agriculture, which supports the Rural Economic Development Loan and Grant program and provides guarantees to the Federal Financing Bank. In the aggregate at February 29, 2012, we had up to \$849 million available under committed loan facilities from the Federal Financing Bank as part of this program. At February 29, 2012 and May 31, 2011, we had up to \$350 million available for advance through October 15, 2013 under a \$500 million committed loan facility from the Federal Financing Bank. In December 2011, we closed an additional \$499 million committed loan facility from the Federal Financing Bank that is available for advance through October 15, 2014 and for which CFC is required to deposit collateral satisfactory to RUS pursuant to the terms of the facility. Advances under both available facilities may have a maturity date of up to 20 years from the date of the advance and the spread we pay over the applicable treasury rate is locked in under this program. Subsequent to February 29, 2012, we borrowed \$169 million under our \$499 million committed loan facility at a weighted average interest rate of 3.005 percent with a repricing period ranging from 10 to 15 years and a final maturity of 20 years.

#### Member Loan Repayments

We expect long-term loan repayments from scheduled loan amortization and prepayments to be \$1,420 million over the next 12 months.

#### Member Loan Interest Payments

During the nine months ended February 29, 2012, interest income on the loan portfolio was \$714 million, representing an average rate of 5.12 percent compared with 5.16 percent for the nine months ended February 29, 2011. For the past three fiscal years, interest income on the loan portfolio has averaged \$1,030 million. At February 29, 2012, 90 percent of the total loans outstanding had a fixed rate of interest, and 10 percent of loans outstanding had a variable rate of



interest.

#### Bank Revolving Credit Agreements

At February 29, 2012 and May 31, 2011, we had \$2,845 million and \$3,559 million, respectively, of commitments under revolving credit agreements. We may request letters of credit for up to \$100 million under each agreement in place at February 29, 2012, which then reduces the amount available under the facility.

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The following table presents the total available and the outstanding letters of credit under our revolving credit agreements:

| (dollar amounts in thousands) | Total available   |              | Letters of credit outstanding |              | Original maturity | Facility fee per year (1) |
|-------------------------------|-------------------|--------------|-------------------------------|--------------|-------------------|---------------------------|
|                               | February 29, 2012 | May 31, 2011 | February 29, 2012             | May 31, 2011 |                   |                           |
| Three-year agreement          | \$ 1,125,000      | \$ 1,125,000 | \$ -                          | \$ -         | March 21, 2014    | 15 basis points           |
| Four-year agreement           | 877,430           | -            | 7,445                         | -            | October 21, 2015  | 10 basis points           |
| Five-year agreement           | 834,875           | -            | -                             | -            | October 21, 2016  | 10 basis points           |
| Five-year agreement           | -                 | 1,049,000    | -                             | -            | March 16, 2012    | 6 basis points            |
| Three-year agreement          | -                 | 1,370,526    | -                             | 14,474       | March 8, 2013     | 25 basis points           |
| Total                         | \$ 2,837,305      | \$ 3,544,526 | \$ 7,445                      | \$ 14,474    |                   |                           |

(1) Facility fee determined by CFC's senior unsecured credit ratings based on the pricing schedules put in place at the inception of the related agreement.

On October 21, 2011, we terminated and replaced our \$1,049 million five-year and \$1,385 million three-year revolving credit agreements with a new \$885 million four-year credit agreement and \$835 million five-year credit agreement expiring on October 21, 2015 and 2016, respectively. The facility fee and applicable margin are determined by the pricing matrices in the agreements based on our senior unsecured credit ratings. With respect to the borrowings, we have the right to choose between a (i) Eurodollar rate plus an applicable margin or (ii) base rate calculated based on the greater of prime rate, the federal funds effective rate plus 0.50 percent or the one-month LIBOR rate plus 1 percent, plus an applicable margin. Similar to the previously existing agreements, our ability to borrow or obtain a letter of credit under both agreements is not conditioned on the absence of material adverse changes with regard to CFC. We also have the right, subject to certain terms and conditions, to increase the aggregate amount of the commitments under each of the credit facilities to a maximum of \$1,300 million.

The revolving credit agreements do not contain a material adverse change clause or ratings triggers that limit the banks' obligations to fund under the terms of the agreements, but we must be in compliance with their other requirements, including financial ratios, to draw down on the facilities. For further discussion see the Compliance with Debt Covenants section.

#### Member Investments

The table below shows the components of our member investments included in total debt outstanding:

| (dollar amounts in thousands)      | February 29, 2012 |                | May 31, 2011 |                | Increase/ (decrease) |
|------------------------------------|-------------------|----------------|--------------|----------------|----------------------|
|                                    | Amount            | % of Total (1) | Amount       | % of Total (1) |                      |
| Commercial paper                   | \$ 978,641        | 37%            | \$ 1,189,770 | 44%            | \$ (211,129)         |
| Daily liquidity fund               | 435,998           | 100            | 308,725      | 100            | 127,273              |
| Medium-term notes                  | 509,789           | 16             | 371,961      | 10             | 137,828              |
| Members' subordinated certificates | 1,756,410         | 100            | 1,813,652    | 100            | (57,242)             |

|       |              |              |            |
|-------|--------------|--------------|------------|
| Total | \$ 3,680,838 | \$ 3,684,108 | \$ (3,270) |
|-------|--------------|--------------|------------|

|                                      |     |     |
|--------------------------------------|-----|-----|
| Percentage of total debt outstanding | 19% | 19% |
|--------------------------------------|-----|-----|

(1) Represents the percentage of each line item outstanding to our members.

Member investments averaged \$3,822 million outstanding during the three years ending February 29, 2012. We view member investments as a more stable source of funding than capital market issuances.

#### Cash Flows from Operations

For the nine months ended February 29, 2012, cash flows provided by operating activities were \$199 million compared with \$185 million for the prior-year period. Our cash flows from operating activities are driven primarily by a combination of cash flows from operating income and the timing and amount of loan interest payments we received compared with interest payments we made on our debt.

#### Compliance with Debt Covenants

At February 29, 2012, we were in compliance with all covenants and conditions under our revolving credit agreements and senior debt indentures.

The following represents our required and actual financial ratios under the revolving credit agreements:

|  | Requirement | February 29,<br>2012 | Actual<br>May 31,<br>2011 |
|--|-------------|----------------------|---------------------------|
| Minimum average adjusted TIER over the six most recent fiscal quarters (1) | 1.025       | 1.20                 | 1.19                      |
| Minimum adjusted TIER for the most recent fiscal year (1) (2)              | 1.05        | 1.21                 | 1.21                      |
| Maximum ratio of adjusted senior debt to total equity (1)                  | 10.00       | 6.35                 | 6.26                      |

(1) In addition to the adjustments made to the leverage ratio set forth in the Non-GAAP Financial Measures section, senior debt excludes guarantees to member systems that have certain investment-grade ratings from Moody's Investors Service and Standard & Poor's Corporation. The TIER calculation includes the adjustments set forth in the Non-GAAP Financial Measures section and excludes the results of operations for CAH.

(2) We must meet this requirement to retire patronage capital.

The revolving credit agreements prohibit liens on loans to members except liens:

- under our indentures,
- related to taxes that are not delinquent or contested,
- stemming from certain legal proceedings that are being contested in good faith,
- created by CFC to secure guarantees by CFC of indebtedness the interest on which is excludable from the gross income of the recipient for federal income tax purposes,
- granted by any subsidiary to CFC, and
- to secure up to \$7,500 million on any other indebtedness of CFC. As of February 29, 2012, the amount of our secured borrowings as defined under all three revolving credit agreements was \$4,584 million.

The revolving credit agreements limit new investments in foreclosed assets held by CAH to \$275 million without consent by the required banks. These investments at February 29, 2012 did not exceed this limit.

The following represents our required and actual financial ratios as defined under our 1994 collateral trust bonds indenture and our medium-term notes indentures in the United States markets:

|   | Requirement | February 29,<br>2012 | Actual<br>May 31,<br>2011 |
|---|-------------|----------------------|---------------------------|
| Maximum ratio of adjusted senior debt to total equity (1) | 20.00       | 7.99                 | 6.98                      |

(1) The ratio calculation includes the adjustments made to the leverage ratio in the Non-GAAP Financial Measures section, with the exception of the adjustments to exclude the non-cash impact of derivative financial instruments and foreign currency adjustments from total liabilities and total equity.

We are required to pledge collateral equal to at least 100 percent of the outstanding balance of debt issued under our collateral trust bond indentures and note purchase agreements with the Federal Agricultural Mortgage Corporation. In addition, we are required to maintain collateral on deposit equal to at least 100 percent of the outstanding balance of

debt outstanding to the Federal Financing Bank under the Guaranteed Underwriter program of the U.S. Department of Agriculture, which supports the Rural Economic Development Loan and Grant program, for which distribution and power supply loans may be deposited. See Pledging of Loans and Loans on Deposit in Note 2, Loans and Commitments, for additional information related to collateral.

The following table summarizes the amount of collateral pledged or on deposit as a percentage of the related debt outstanding under the debt agreements noted above:

|  | Requirement                  |  | Actual               |                 |
|--|------------------------------|--|----------------------|-----------------|
|  | Debt<br>indenture<br>minimum | Revolving<br>credit<br>agreements<br>maximum | February 29,<br>2012 | May 31,<br>2011 |
| Debt agreement                                   |                              |  |                      |                 |
| Collateral trust bonds                           | 100%                         | 150%   | 112%                 | 115%            |
| Federal Agricultural Mortgage<br>Corporation     | 100                          | 150  | 118                  | 127             |
| Clean Renewable Energy Bonds Series 2009A<br>(1) | 100                          | 150  | 120                  | 118             |
| Federal Financing<br>Bank (2)                    | 100                          | 150  | 112                  | 115             |

(1) The limit of 150 percent on collateral pledged under the revolving credit agreements excludes cash pledged as collateral of \$7 million and \$8 million as of February 29, 2012 and May 31, 2011, respectively.

(2) Represents collateral on deposit as a percentage of the related debt outstanding.

## Uses of Liquidity

### Loan Advances

Loan advances are either from new loans approved to borrowers or from the unadvanced portion of loans previously approved. At February 29, 2012, unadvanced loan commitments totaled \$14,137 million. Of that total at February 29, 2012, \$1,267 million represented unadvanced commitments related to line of credit loans that are not subject to a material adverse change clause at the time of each loan advance. As such, we would be required to advance amounts on these committed facilities as long as the borrower is in compliance with the terms and conditions of the loan. New advances under 50 percent of these committed facilities would be advanced at CFC's standard rates and, therefore, any increase in CFC's costs to obtain funding required to make the advance could be passed on to the borrower. The other 50 percent of committed facilities represent loan syndications where the pricing is set at a spread over a market index as agreed upon by all of the participating banks and market conditions at the time of syndication. The remaining \$12,870 million of unadvanced loan commitments at February 29, 2012 were generally subject to material adverse change clauses. Prior to making an advance on these facilities, we would confirm that there has been no material adverse change in the borrowers' business or financial condition since the time the loan was approved and confirm that the borrower is currently in compliance with loan terms and conditions.

Since we generally do not charge a fee for the borrower to have an unadvanced amount on a loan facility that is subject to a material adverse change clause, our borrowers tend to request amounts in excess of their immediate estimated loan requirements. It has been our history that we do not see significant loan advances from the large amount of long-term unadvanced loan amounts that are subject to material adverse change clauses at the time of the loan advance. We have a very low historical average utilization rate on all our line of credit unadvanced loans, including committed line of credit facilities. Unadvanced commitments related to line of credit loans are typically revolving facilities for periods not to exceed five years. Unadvanced commitments for long-term loans typically expire within five years of the first loan advance. The above items all contribute to our expectation that the majority of the unadvanced commitments reported will expire without being fully drawn upon and that the total commitment amount does not necessarily represent future cash funding requirements at February 29, 2012.

We currently expect to make long-term loan advances totaling approximately \$1,430 million to our members over the next 12 months.

### Interest Expense on Debt

For the nine months ended February 29, 2012, interest expense on debt was \$568 million, representing an average cost of 4.14 percent compared with 4.50 percent for the nine months ended February 28, 2011. For the past three fiscal years, interest expense on debt has averaged \$875 million. At February 29, 2012, 80 percent of outstanding debt had a fixed interest rate and 20 percent had a variable interest rate.

### Principal Repayments on Long-Term Debt

The principal amount of medium-term notes, collateral trust bonds, long-term notes payable, subordinated deferrable debt and membership subordinated certificates maturing by fiscal year and thereafter is as follows:

| (dollar amounts in thousands) | Outstanding balance | Remaining maturities for the years ended May 31, |             |             |            |             | Thereafter |
|-------------------------------|---------------------|--|-------------|-------------|------------|-------------|------------|
|                               |                     | 2012   | 2013        | 2014        | 2015       | 2016        |            |
| Long-term debt                | \$                  | \$   | \$1,196,801 | \$2,418,464 | \$ 874,252 | \$1,003,105 | \$         |
| (1)                           | 15,886,050          | 1,351,754  |             |             |            |             | 9,041,674  |

(1) Excludes loan subordinated certificates totaling \$165 million that amortize annually based on the outstanding balance of the related loan. There are many items that affect the amortization of a loan, such as loan conversions, loan repricing at the end of an interest rate term and prepayments; therefore, an amortization schedule cannot be maintained

for these certificates. Over the past three years, annual amortization on these certificates has averaged \$23 million. In fiscal year 2011, amortization represented 16 percent of amortizing loan subordinated certificates outstanding.

#### Patronage Capital Retirements

CFC has made annual retirements of allocated net earnings in 32 of the last 33 years. In July 2011, the CFC Board of Directors approved the allocation of \$92 million from fiscal year 2011 net earnings to CFC's members. CFC made a cash payment of \$46 million to its members in September 2011 as retirement of 50 percent of allocated net earnings from the prior year as approved by the CFC Board of Directors. The remaining portion of allocated net earnings will be retained by CFC for 25 years under guidelines adopted by the CFC Board of Directors in June 2009.

#### Market Risk

Our primary market risks are liquidity risk, interest rate risk and counterparty risk as a result of entering into derivative financial instruments.

### Liquidity Risk

We face liquidity risk in funding our loan portfolio and refinancing our maturing obligations. Our Asset Liability Committee monitors liquidity risk by establishing and monitoring liquidity targets, as well as strategies and tactics to meet those targets, and ensuring that sufficient liquidity is available for unanticipated contingencies.

We face liquidity risk in the funding of our loan portfolio based on member demand for new loans, although as presented in our projected sources and uses of liquidity chart on page 50, we expect over the next six quarters that repayments on our long-term loans will exceed long-term loan advances by an estimated \$133 million.

At February 29, 2012, we had \$3,400 million of commercial paper, daily liquidity fund and bank bid notes scheduled to mature during the next 12 months. Based on past history, we expect to continue to maintain member investments in commercial paper and the daily liquidity fund at approximately the current level of \$1,415 million at February 29, 2012, which represents a decrease of \$84 million from the balance at May 31, 2011. Dealer commercial paper and bank bid notes increased from \$1,767 million at May 31, 2011 to \$1,922 million at February 29, 2012. We expect that the dealer commercial paper balance will fluctuate to offset changes in demand from our members. We intend to maintain the current level of commercial paper outstanding while favorable market conditions exist. We intend to limit the balance of dealer commercial paper and bank bid notes outstanding to 15 percent or less of total debt outstanding. At February 29, 2012, 15 percent of total debt outstanding was \$2,918 million. In order to access the commercial paper markets at current levels, we believe we need to maintain our current ratings for commercial paper of P1 from Moody's Investors Service and A1 from Standard & Poor's Corporation.

We use our bank lines of credit as backup liquidity, primarily for dealer and member commercial paper. At February 29, 2012, we had \$2,837 million in available lines of credit with financial institutions. We expect to be in compliance with the covenants under our revolving credit agreements; therefore, we could draw on these facilities to repay dealer or member commercial paper that cannot be rolled over in the event of market disruptions.

At February 29, 2012, we had long-term debt maturing in the next 12 months totaling \$2,409 million. In addition to our access to the dealer and member commercial paper markets as discussed above, we believe we will be able to refinance these maturing obligations because:

- Using restricted cash on hand at February 29, 2012, on March 1, 2012 we paid down \$1 billion of medium-term notes that matured on that date. Based on our funding sources available and past history, we believe we will meet our obligation to refinance the remaining \$234 million of medium-term notes sold through dealers and \$403 million of medium-term notes sold to members that mature over the next 12 months with new medium-term notes including those in the retail notes market.
- We expect to maintain the ability to obtain funding through the capital markets. During fiscal year 2012 and through the filing date, we issued \$400 million of medium-term notes and \$800 million of collateral trust bonds in registered offerings.
- We can borrow up to \$3,900 million under a note purchase agreement with the Federal Agriculture Mortgage Corporation at any time through January 11, 2016, subject to market conditions for debt issued by the Federal Agricultural Mortgage Corporation. We had up to \$2,489 million available under this revolving note purchase agreement at February 29, 2012.
- At February 29, 2012, we had the ability to borrow up to \$849 million from the Federal Financing Bank with a guarantee of repayment by RUS under the Guaranteed Underwriter program of the U.S. Department of Agriculture, which supports the Rural Economic Development Loan and Grant program and provides guarantees to the Federal Financing Bank. A total of \$350 million was available for advance through October 15, 2013. A total of \$499 million was available for advance through October 15, 2014 and CFC is required to deposit collateral satisfactory to RUS pursuant to the terms of the facility. Advances may have a maturity date of up to 20 years from the date of the advance. The spread we pay over the applicable treasury rate is locked in under this program. Subsequent to



February 29, 2012, we borrowed \$169 million under our \$499 million committed loan facility at a weighted average interest rate of 3.005 percent with a repricing period ranging from 10 to 15 years and a final maturity of 20 years.

At February 29, 2012, we are the guarantor and liquidity provider for \$499 million of tax-exempt bonds issued for our member cooperatives. We have also issued letters of credit to provide standby liquidity for an additional \$125 million of tax-exempt bonds. During the nine months ended February 29, 2012, we were not required to perform as liquidity provider pursuant to these obligations.

We expect that our current sources of liquidity, along with our \$1,465 million of cash and restricted cash on hand at February 29, 2012, will allow us to meet our obligations and to fund our operations over the next 12 to 18 months.

### Interest Rate Risk

Our interest rate risk exposure is related to the funding of the fixed-rate loan portfolio. Our Asset Liability Committee monitors interest rate risk by meeting at least quarterly to review the following information: national economic forecasts, forecasts for the federal funds rate and the interest rates that we set, interest rate gap analysis, liquidity position, schedules of loan and debt maturities, short- and long-term funding needs, anticipated loan demands, credit concentration status, derivatives portfolio and financial forecast. The Asset Liability Committee also discusses the composition of fixed-rate versus variable-rate lending, new funding opportunities, changes to the nature and mix of assets and liabilities for structural mismatches and interest rate swap transactions.

### Matched Funding Practice

We provide our members with many options on loans with regard to interest rates, the term for which the selected interest rate is in effect, and the ability to convert or prepay the loan. Long-term loans typically have maturities of up to 35 years. Borrowers may select fixed interest rates for periods of one year through the life of the loan. Each time borrowers select a rate, it is at our current market rate for that type of loan. We do not match fund the majority of our fixed-rate loans with a specific debt issuance at the time the loans are advanced. To monitor and mitigate interest rate risk in the funding of fixed-rate loans, we perform a monthly interest rate gap analysis, a comparison of fixed-rate assets repricing or maturing by year to fixed-rate liabilities and members' equity maturing by year (see table below). Fixed-rate liabilities include debt issued at a fixed rate as well as variable-rate debt swapped to a fixed rate using interest rate swaps. Fixed-rate debt swapped to a variable rate using interest rate swaps is excluded from the analysis since it is used to match fund the variable-rate loan pool. With the exception of members' subordinated certificates, which are generally issued at rates below our long-term cost of funding and with extended maturities, and commercial paper, our liabilities have average maturities that closely match the repricing terms (but not the maturities) of our fixed-interest rate loans.

We fund the amount of fixed-rate assets that exceed fixed-rate debt and members' equity with short-term debt, primarily commercial paper. We also have the option to enter pay fixed-receive variable interest rate swaps. Our funding objective is to manage the matched funding of asset and liability repricing terms within a range of total assets excluding derivative assets deemed appropriate by the Asset Liability Committee based on the current environment and extended outlook for interest rates. Due to the flexibility we offer our borrowers, there is a possibility of significant changes in the composition of the fixed-rate loan portfolio, and the management of the interest rate gap is very fluid. We may use interest rate swaps to adjust the interest rate gap based on our needs for fixed-rate or variable-rate funding as changes arise. The interest rate risk is deemed minimal on variable-rate loans since the loans may be repriced either monthly or semi-monthly therefore minimizing the variance to the cost of variable-rate debt used to fund the loans. At February 29, 2012 and May 31, 2011, 10 percent and 14 percent, respectively, of loans carried variable interest rates.

Our interest rate gap analysis also allows us to analyze the effect on the overall adjusted TIER of issuing a certain amount of debt at a fixed rate for various maturities before the issuance of the debt. See Non-GAAP Financial Measures for further explanation and a reconciliation of the adjustments to TIER.

The following table shows the scheduled amortization and repricing of fixed-rate assets and liabilities outstanding at February 29, 2012.

#### Interest Rate Gap Analysis (Fixed-Rate Assets/Liabilities) February 29, 2012

| (dollar amounts in millions) | May 31,<br>2012 | June<br>1, | June<br>1, | June<br>1, | June<br>1, | Beyond<br>June 1, | Total |
|------------------------------|-----------------|------------|------------|------------|------------|-------------------|-------|
|------------------------------|-----------------|------------|------------|------------|------------|-------------------|-------|

|  | or<br>prior | 2012<br>to<br>May<br>31,<br>2014 | 2014<br>to<br>May<br>31,<br>2016 | 2016<br>to<br>May<br>31,<br>2021 | 2021<br>to<br>May<br>31,<br>2031 | 2031     |           |
|--|-------------|----------------------------------|----------------------------------|----------------------------------|----------------------------------|----------|-----------|
| Assets amortization and repricing                  | \$ 587      | \$ 4,589                         | \$ 3,170                         | \$ 4,155                         | \$ 3,164                         | \$ 1,117 | \$ 16,782 |
| Liabilities and members' equity:                   |             |                                  |                                  |                                  |                                  |          |           |
| Long-term debt                                     | \$ 574      | \$ 3,384                         | \$ 2,836                         | \$ 4,508                         | \$ 1,442                         | \$ 671   | \$ 13,415 |
| Subordinated certificates                          | 8           | 50                               | 41                               | 85                               | 1,029                            | 431      | 1,644     |
| Members' equity (1)                                | -           | -                                | -                                | 39                               | 237                              | 457      | 733       |
| Total liabilities and members' equity              | \$ 582      | \$ 3,434                         | \$ 2,877                         | \$ 4,632                         | \$ 2,708                         | \$ 1,559 | \$ 15,792 |
| Gap (2)  | \$ 5        | \$ 1,155                         | \$ 293                           | \$ (477)                         | \$ 456                           | \$ (442) | \$ 990    |
| Cumulative gap                                     | 5           | 1,160                            | 1,453                            | 976                              | 1,432                            | 990      |           |
| Cumulative gap as a % of total assets              | 0.02%       | 5.54%                            | 6.94%                            | 4.66%                            | 6.84%                            | 4.73%    |           |
| Cumulative gap as a % of adjusted total assets (3) | 0.02        | 5.62                             | 7.04                             | 4.73                             | 6.94                             | 4.80     |           |

- (1) Includes the portion of the loan loss allowance and subordinated deferrable debt allocated to fund fixed-rate assets and excludes non-cash adjustments from the accounting for derivative financial instruments.
- (2) Assets less liabilities and members' equity.
- (3) Adjusted total assets represent total assets in the consolidated balance sheet less derivative assets.

At February 29, 2012, we had \$16,782 million of fixed-rate assets amortizing or repricing, funded by \$13,415 million of fixed-rate liabilities maturing during the next 30 years and \$2,377 million of members' equity and members' subordinated certificates, a portion of which does not have a scheduled maturity. The difference of \$990 million, or 4.73 percent of total assets and 4.80 percent of total assets excluding derivative assets, represents the fixed-rate assets maturing during the next 30 years in excess of the fixed-rate debt and members' equity. Our Asset Liability Committee believes that the difference in the matched funding at February 29, 2012 as a percentage of total assets less derivative assets is appropriate based on the extended outlook for interest rates and allows the flexibility to maximize funding opportunities in the current low interest rate environment. Funding fixed-rate loans with short-term debt presents a liquidity risk of being able to roll over the short-term debt until we issue term debt to fund the fixed-rate loans through their repricing or maturity date. Factors that mitigate this risk include our maintenance of liquidity available at February 29, 2012 through committed revolving credit agreements totaling \$2,837 million with domestic and foreign banks, \$849 million under committed loan facilities from the Federal Financing Bank, and, subject to market conditions, up to \$2,489 million under a revolving note purchase agreement with the Federal Agriculture Mortgage Corporation.

#### Derivative Financial Instruments

We are an end-user of financial derivative instruments. We use derivatives such as interest rate swaps, treasury locks for forecasted transactions, cross-currency swaps and cross-currency interest rate swaps to mitigate interest rate and foreign currency exchange risk. These derivatives are used when they provide a lower cost of funding or minimize interest rate risk as part of our overall interest rate matching strategy. We have not entered into derivative financial instruments for trading purposes in the past and do not anticipate doing so in the future. At February 29, 2012 and May 31, 2011, there were no foreign currency derivative instruments outstanding. At February 29, 2012 and May 31, 2011, we did not have any interest rate exchange agreements that were accounted for using hedge accounting. Cash settlements that we pay and receive for derivative instruments that do not qualify for hedge accounting are recorded in the derivative losses line in the consolidated statements of operations.

#### Counterparty Risk

We are exposed to counterparty risk related to the performance of the parties with which we entered into derivative instruments. To mitigate this risk, we only enter into these agreements with financial institutions with investment-grade ratings. At February 29, 2012 and May 31, 2011, the highest percentage concentration of total notional exposure to any one counterparty was 17 percent and 13 percent, respectively, of total derivative instruments. At the time counterparties are selected to participate in our exchange agreements, the counterparty must be a participant in one of our revolving credit agreements. In addition, the derivative instruments executed for each counterparty are based on key characteristics such as the following: notional concentration, credit risk exposure, tenor, bid success rate, total credit commitment and credit ratings. At February 29, 2012, our derivative instrument counterparties had credit ratings ranging from AA to BBB+ as assigned by Standard & Poor's Corporation and Aaa to Baal as assigned by Moody's Investors Service. Based on the fair market value of our derivative instruments at February 29, 2012, there were four counterparties that would be required to make a payment to us totaling \$60 million if all of our derivative instruments were terminated on that day. The largest amount owed to us by a single counterparty was \$23 million, or 39 percent of the total exposure to us, at February 29, 2012.

#### Rating Triggers

Some of our interest rate swaps have credit risk-related contingent features referred to as rating triggers. Rating triggers are not separate financial instruments and are not required to be accounted for separately as derivatives. At February 29, 2012, the following notional amounts of derivative instruments had rating triggers based on our senior unsecured credit ratings from Moody's Investors Service or Standard & Poor's Corporation falling to a level specified in the applicable agreements and are grouped into the categories below. In calculating the payments and collections required upon termination, we netted the agreements for each counterparty, as allowed by the underlying master agreements. At February 29, 2012, our senior unsecured credit ratings from Moody's Investors Service and Standard & Poor's Corporation were A2 and A, respectively. At February 29, 2012, both Moody's Investors Service and Standard & Poor's Corporation had our ratings on stable outlook.

| (dollar amounts in thousands)     | Notional<br>amount | Our<br>required<br>payment | Amount we<br>would<br>collect | Net<br>total |
|-----------------------------------|--------------------|----------------------------|-------------------------------|--------------|
| Mutual rating trigger if ratings: |                    |                            |                               |              |
| fall to Baa1/BBB+ (1)             | \$ 3,000           | \$ (230)                   | \$ -                          | \$ (230)     |
| fall below Baa1/BBB+ (1)          | 7,107,125          | (239,161)                  | 57,733                        | (181,428)    |
| Total                             | \$ 7,110,125       | \$ (239,391)               | \$ 57,733                     | \$ (181,658) |

(1) Stated senior unsecured credit ratings are for Moody's Investors Service and Standard & Poor's Corporation, respectively. Under these rating triggers, if the credit rating for either counterparty falls to the level specified in the agreement, the other counterparty may, but is not obligated to, terminate the agreement. If either counterparty terminates the agreement, a net payment may be due from one counterparty to the other based on the fair value, excluding credit risk, of the underlying derivative instrument.

In addition to the rating triggers listed above, at February 29, 2012, we had a total notional amount of \$688 million of derivative instruments with one counterparty that would require the pledging of collateral totaling \$18 million (the fair value of such derivative instruments excluding credit risk) if our senior unsecured ratings from Moody's Investors Service were to fall below Baa2 or if our ratings from Standard & Poor's Corporation were to fall below BBB. The aggregate fair value of all interest rate swaps with rating triggers that were in a net liability position at February 29, 2012 was \$252 million.

For additional information about the risks related to our business, see Item 1A. Risk Factors.

#### Non-GAAP Financial Measures

We make certain adjustments to financial measures in assessing our financial performance that are not in accordance with GAAP. These non-GAAP adjustments fall primarily into two categories: (i) adjustments related to the calculation of the TIER and (ii) adjustments related to the calculation of the leverage and debt-to-equity ratios. These adjustments reflect management's perspective on our operations, and in several cases, adjustments used to measure covenant compliance under our revolving credit agreements. Therefore, we believe these are useful financial measures for investors. We refer to our non-GAAP financial measures as "adjusted" throughout this document.

#### Adjustments to Net Income and the Calculation of TIER

The following table provides a reconciliation between interest expense and net interest income and these financial measures adjusted to include the impact of derivatives. Additionally, it provides a reconciliation of net income and this financial measure adjusted to exclude the impact of derivatives. Refer to Non-GAAP Financial Measures in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, in our Form 10-K for the year ended May 31, 2011 for an explanation of why these adjustments to the line items below and the calculation of the TIER ratio reflect management's perspective on our operations and why we believe these are useful financial measures for investors.

|  | For the three months ended |                         | For the nine months ended |                         |
|--|----------------------------|-------------------------|---------------------------|-------------------------|
|  | February<br>29,<br>2012    | February<br>28,<br>2011 | February<br>29,<br>2012   | February<br>28,<br>2011 |
| (dollar amounts in thousands)                                |                            |                         |                           |                         |
| Interest expense   | \$ (190,294)               | \$ (206,333)            | \$ (587,018)              | \$ (638,246)            |
| Including: Derivative cash<br>settlements                    | 531                        | (850)                   | (283)                     | (5,685)                 |
| Adjusted interest expense                                    | \$ (189,763)               | \$ (207,183)            | \$ (587,301)              | \$ (643,931)            |
| Net interest income  | \$ 47,724                  | \$ 47,969               | \$ 136,005                | \$ 117,627              |
| Including: Derivative cash<br>settlements                    | 531                        | (850)                   | (283)                     | (5,685)                 |
| Adjusted net interest income                                 | \$ 48,255                  | \$ 47,119               | \$ 135,722                | \$ 111,942              |
| Net (loss) income prior to<br>cumulative effect of change in | \$ (37,299)                | \$ 83,652               | \$ (151,215)              | \$ 131,979              |

|                               |             |           |           |            |
|-------------------------------|-------------|-----------|-----------|------------|
| accounting principle          |             |           |           |            |
| Excluding: Derivative forward |             | )         |           | )          |
| value                         | 26,094      | (54,198   | 184,604   | (28,090    |
| Adjusted net income           | \$ (11,205) | \$ 29,454 | \$ 33,389 | \$ 103,889 |

TIER using GAAP financial measures is calculated as follows:

$$\text{TIER} = \frac{\text{Interest expense} + \text{net income prior to cumulative effect of change in accounting principle}}{\text{Interest expense}}$$

Our adjusted TIER is calculated as follows:

$$\text{Adjusted TIER} = \frac{\text{Adjusted interest expense} + \text{adjusted net income}}{\text{Adjusted interest expense}}$$

The following table presents our TIER and adjusted TIER:

|               | For the three months ended |                         | For the nine months ended |                      |
|---------------|----------------------------|-------------------------|---------------------------|----------------------|
|               | February 29,<br>2012       | February<br>28,<br>2011 | February 29,<br>2012      | February 28,<br>2011 |
| TIER (1)      | -                          | 1.41                    | -                         | 1.21                 |
| Adjusted TIER | -                          | 1.14                    | 1.06                      | 1.16                 |

(1) For the three and nine months ended February 29, 2012, we reported net losses of \$37 million and \$151 million, respectively, and, therefore, the TIER calculation for that period results in a value below 1.00.

#### Adjustments to the Calculation of Leverage and Debt-to-Equity Ratios

The following table provides a reconciliation between the liabilities and equity used to calculate the leverage and debt-to-equity ratios and these financial measures adjusted to exclude the non-cash effects of derivatives and foreign currency adjustments, to subtract debt used to fund loans that are guaranteed by RUS from total liabilities, and to subtract from total liabilities, and add to total equity, debt with equity characteristics. Refer to Non-GAAP Financial Measures in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, in our Form 10-K for the year ended May 31, 2011 for an explanation of why these adjustments to the calculation of leverage and debt-to-equity ratios reflect management's perspective on our operations and why we believe these are useful financial measures for investors.

| (dollar amounts in thousands)  | February 29,<br>2012 | May 31,<br>2011 |
|--|----------------------|-----------------|
| Liabilities  | \$ 20,443,721        | \$ 19,874,313   |
| Less:  |                      |                 |
| Derivative liabilities   | (620,392)            | (477,433)       |
| Debt used to fund loans guaranteed<br>by RUS   | (220,257)            | (226,695)       |
| Subordinated deferrable debt   | (186,440)            | (186,440)       |
| Subordinated certificates (1)  | (1,756,410)          | (1,813,652)     |
| Adjusted liabilities   | \$ 17,660,222        | \$ 17,170,093   |
| Total equity   | \$ 488,657           | \$ 687,309      |
| Less:  |                      |                 |
| Prior year cumulative derivative<br>forward<br>value and foreign currency<br>adjustments | 142,252              | 118,864         |
| Year-to-date derivative forward<br>value loss  | 184,604              | 23,388          |
| Accumulated other comprehensive income (2)   | (8,517)              | (9,273)         |
| Plus:  |                      |                 |
| Subordinated certificates (1)  | 1,756,410            | 1,813,652       |
| Subordinated deferrable debt   | 186,440              | 186,440         |
| Adjusted equity  | \$ 2,749,846         | \$ 2,820,380    |
| Guarantees   | \$ 1,149,809         | \$ 1,104,988    |

(1) Includes \$15 million and \$12 million of subordinated certificates classified in short-term debt at February 29, 2012 and May 31, 2011, respectively.



(2) Represents the accumulated other comprehensive income related to derivatives. Excludes \$0.6 million and \$0.5 million of accumulated other comprehensive income related to the unrecognized gains on our investments at February 29, 2012 and May 31, 2011, respectively.

The leverage and debt-to-equity ratios using GAAP financial measures are calculated as follows:

$$\text{Leverage ratio} = \frac{\text{Liabilities + guarantees outstanding}}{\text{Total equity}}$$

$$\text{Debt-to-equity ratio} = \frac{\text{Liabilities}}{\text{Total equity}}$$

The adjusted leverage and debt-to-equity ratios are calculated as follows:

$$\text{Adjusted leverage ratio} = \frac{\text{Adjusted liabilities + guarantees outstanding}}{\text{Adjusted equity}}$$

$$\text{Adjusted debt-to-equity ratio} = \frac{\text{Adjusted liabilities}}{\text{Adjusted equity}}$$

The following table provides the calculated ratio for leverage and debt-to-equity, as well as the adjusted ratio calculations.

|                               | February 29,<br>2012 | May 31,<br>2011 |
|-------------------------------|----------------------|-----------------|
| Leverage ratio                | 44.19                | 30.52           |
| Adjusted leverage ratio       | 6.84                 | 6.48            |
| Debt-to-equity ratio          | 41.84                | 28.92           |
| Adjusted debt-to-equity ratio | 6.42                 | 6.09            |

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

See Market Risk discussion beginning on page 54.

Item 4. Controls and Procedures

At the end of the period covered by this report, senior management, including the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. Based on this evaluation process, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective. There were no changes in our internal control over financial reporting that occurred during the three months ended February 29, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item Risk Factors  
1A.

Refer to Part I, Item 1A. Risk Factors in our Form 10-K for the year ended May 31, 2011 for information regarding factors that could affect our results of operations, financial condition and liquidity. There have been no material changes to our risk factors described in our Form 10-K for the year ended May 31, 2011.

Item 5. Other Information

None.

Item 6. Exhibits

- 31.1 –Certification of the Chief Executive Officer required by Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 –Certification of the Chief Financial Officer required by Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 –Certification of the Chief Executive Officer required by Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 –Certification of the Chief Financial Officer required by Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.01 –Financial statements from the Quarterly Report on Form 10-Q of National Rural Utilities Cooperative Finance Corporation for the quarter ended February 29, 2012, formatted in XBRL: (i) the Condensed Consolidated Statements of Operations, (ii) the Condensed Consolidated Balance Sheets, (iii) the Condensed Consolidated Statement of Changes in Equity, (iv) the Condensed Consolidated Statements of Cash Flows and (v) the Notes to Consolidated Financial Statements.

Signatures

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

NATIONAL RURAL UTILITIES COOPERATIVE  
FINANCE CORPORATION

/s/ STEVEN L. LILLY  
Steven L. Lilly  
Chief Financial Officer

/s/ ROBERT E. GEIER  
Robert E. Geier  
Controller  
(Principal Accounting Officer)

April 16, 2012

