FLUOR CORP
Form 424B2
February 12, 2004

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Filed pursuant to Rule 424(b)(2)
of the Securities Act of 1933
Registration Nos. 333-63984 and 333-112644

PROSPECTUS SUPPLEMENT
(To Prospectus Dated September 18, 2002)

$300,000,000

Fluor Corporation

1.50% Convertible Senior Notes due 2024

The notes will bear interest at a rate of 1.50% per annum. We will pay interest on the notes on February 15 and August 15 of each year, beginning August 15, 2004. The notes will mature on February 15, 2024. The notes will be our senior unsecured obligations and will rank equally with all of our other senior unsecured debt.

On or after February 17, 2005, the notes will be convertible at your option into shares of our common stock, par value $0.01 per share, if: (1) the price of our common stock reaches a specified threshold, (2) the notes have been called for redemption, or (3) specified corporate transactions occur. Upon conversion, we will have the right to deliver, in lieu of our common stock, cash or a combination of cash and shares of our common stock. Subject to the above conditions, each $1,000 principal amount of notes will be convertible into 17.8750 shares of our common stock (equivalent to an initial conversion price of $55.94 per share of common stock), subject to adjustment as described in this prospectus supplement. Shares of our common stock are traded on the New York Stock Exchange under the symbol FLR. The closing sale price of our common stock on February 10, 2004 was $39.96 per share.

We may redeem some or all of the notes for cash at any time on or after February 16, 2009 at 100% of their principal amount, plus accrued and unpaid interest, if any, to but excluding the purchase date.

You may require us to purchase all or a portion of your notes on February 15, 2009, 2014 and 2019, at 100% of their principal amount, plus accrued and unpaid interest, if any, to but excluding each purchase date.

You may require us to repurchase all or a portion of your notes upon the occurrence of a fundamental change (as defined in this prospectus supplement) at 100% of their principal amount, plus accrued and unpaid interest, if any, to but excluding the repurchase date.

Investing in the notes involves risks. See Risk Factors beginning on page S-9.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or the related prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Note	Total
Public Offering Price	100%	$300,000,000
Underwriting Discount	2%	$ 6,000,000
Proceeds to Fluor Corporation (before expenses)	98%	$294,000,000

We have granted the underwriters an option to purchase up to an additional $30,000,000 aggregate principal amount of the notes solely to cover over-allotments.

The underwriters expect to deliver the notes in book-entry form on or about February 17, 2004.

Joint Book-Running Managers

Banc of America Securities LLC **Citigroup**

Senior Co-Manager

Lehman Brothers **BNP PARIBAS**

February 11, 2004

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We have not authorized anyone else to provide you with any information other than the information provided in or incorporated by reference into this prospectus supplement or the related prospectus. We cannot assure the reliability of any different information. We are not making an offer of the notes in any state where the offer is not permitted. This prospectus supplement and the related prospectus may be updated from time to time, so you should not assume that the information in this prospectus supplement or the related prospectus is accurate as of any date other than the respective dates on the front of this prospectus supplement and the related prospectus.

Investing in the notes involves risks that are described in the Risk Factors section beginning on page S-9.

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As used in this prospectus supplement and the related prospectus, unless the context otherwise requires, the terms Fluor, Fluor Corporation, us, we, or our refer to Fluor Corporation, a Delaware corporation, together with its subsidiaries. Unless otherwise indicated, all information in this prospectus supplement assumes no exercise of the over-allotment option granted to the underwriters.

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INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

This prospectus supplement, the related prospectus and the documents incorporated herein by reference contain forward-looking statements. When used in this prospectus supplement, the related prospectus and the documents incorporated herein by reference, the words may, will, should, predict, continue, plans, expects, anticipates, estimates, intends, believe, could and similar expressions are intended to forward-looking statements. For example, statements that relate to our expectations regarding growth, projected earning levels, market outlook, new awards, backlog levels, competition, the adequacy of funds to service debt and the implementation of new strategic initiatives are forward-looking in nature. These forward-looking statements reflect our current analysis of existing information, although no assurance can be given that such statements will be realized.

Due to unknown risks and uncertainties, our actual results may differ materially from the expectations or projections of our forward-looking statements. As a result, caution must be exercised in relying on forward-looking statements. The factors potentially contributing to such differences include, among others:

- changes in global business, economic, political and social conditions;
- our failure to receive anticipated new contract awards;
- customer cancellations of, or scope adjustments to, existing contracts;
- the cyclical nature of many of the markets we serve and their vulnerability to downturns;
- difficulties or delays incurred in the execution of construction contracts resulting in cost overruns or liabilities;
- failure to obtain favorable results in existing or future litigation or disputes;
- recoveries from our insurance providers that are less than anticipated;
- customer delays or defaults in making payments;
- risks and impacts resulting from our reverse spin-off transaction completed on November 30, 2000 involving Massey Energy Company;
- the impact of past and future environmental, health and safety regulations and lawsuits;
- competition in the global engineering, procurement and construction industry; and
- our ability to identify and successfully integrate acquisitions.

The forward-looking statements are also based on various operating assumptions regarding, among other matters, overhead costs and employment levels that may not be realized. In addition, while most risks affect only future costs or revenues that we anticipate we will receive, some risks may relate to accruals that have already been reflected in earnings. Our failure to receive payments of these accrued earnings could result in charges against future earnings.

These and other risks and uncertainties are described in this prospectus supplement under the Risk Factors section and in our filings made from time to time with the SEC. The cautionary statements made in this prospectus supplement should be read as being applicable to all related forward-looking statements wherever they appear. We assume no obligation to publicly update or revise any forward-looking statement for any reason, or to update the reasons actual results could differ materially from the expectations or projections of our forward-looking statements, even if new information becomes available in the future.

ADDITIONAL INFORMATION

We file annual, quarterly and periodic special reports, proxy statements and other information with the SEC. You may read and copy any document we file at the SEC s Public Reference Section at 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of these documents may be obtained from the SEC s Public Reference Section at 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. Please

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call the SEC at 1-800-732-0330 for further information on the public reference rooms. Our SEC filings are also available to the public over the Internet at the SEC s web site at *http://www.sec.gov*. You may also read copies of these documents at the offices of the New York Stock Exchange.

The SEC allows us to incorporate by reference the information contained in documents that we file with them, which means that we can disclose important information to you by referring you to those documents. The information incorporated by reference is an important part of this prospectus and any prospectus supplement, and information that we file later with the SEC will automatically update and supersede some or all of this information. We incorporate by reference the documents listed below and any future filings made with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934, until we sell all of the debt securities.

Our Annual Report on Form 10-K for the year ended December 31, 2002;

Our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2003, June 30, 2003 and September 30, 2003;

Our Current Report on Form 8-K filed on December 3, 2003;

Our Current Report on Form 8-K furnished on February 5, 2004 (except for the statements attributed to our Chairman and Chief Executive Officer, Alan Boeckmann, and the two paragraphs under the Outlook section); and

The description of our common stock contained in our Registration Statement on Form 10, filed with the SEC on September 20, 2000 (as amended by Amendment No. 1 thereto on Form 10/ A, filed with the SEC on November 22, 2000).

You may request a copy of these filings, at no cost, by writing or telephoning us at our principal executive offices at the following address:

Fluor Corporation

One Enterprise Drive
Aliso Viejo, California 92656
Attention: Corporate Secretary
(949) 349-2000.

We have filed exhibits with the registration statement that include the form of underwriting agreement and indenture. You should read the exhibits carefully for provisions that may be important to you.

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SUMMARY

The following summary contains information about Fluor and the offering of the notes. It does not contain all of the information that may be important to you in making a decision to purchase the notes. For a more complete understanding of Fluor and the offering of the notes, we urge you to read this entire prospectus supplement and the related prospectus carefully, including the Risk Factors section, the documents incorporated by reference herein, and our consolidated financial statements and related notes contained in such documents.

Fluor Corporation

Fluor Corporation is a leading professional services company offering a diverse range of value-added, knowledge-based services from traditional engineering, procurement and construction services to total asset management. Fluor Corporation is a holding company which owns, directly or indirectly, the stock of numerous subsidiary corporations, including its primary operating subsidiary Fluor Enterprises, Inc. Fluor Enterprises is aligned into five principal operating segments.

The Oil & Gas segment provides engineering and construction professional services for upstream oil and gas production, downstream refining and certain petrochemical markets.

The Industrial & Infrastructure segment provides engineering and construction professional services for manufacturing and life sciences facilities, commercial and institutional buildings, mining, downstream bulk and specialty chemicals, telecommunications and transportation projects and other facilities.

The Power segment provides professional services to engineer, construct and maintain power generation facilities.

The Global Services segment provides operations and maintenance support, equipment and temporary staffing services and global sourcing and procurement solutions.

The Government Services segment provides project management, engineering, construction and contingency response services to the U.S. government and other governmental parties.

Fluor Corporation also operates through Fluor Constructors International, Inc., which is organized and operates separately from Fluor Enterprises. Fluor Constructors provides unionized management, construction and management services in the United States and Canada, both independently and as a subcontractor to Fluor Enterprises.

On November 30, 2000, Fluor Corporation completed a reverse spin-off transaction in which its coal segment, previously operated under its A.T. Massey Coal Company, Inc. subsidiary, was separated from the other business segments of Fluor Corporation.

Fluor Corporation was incorporated in Delaware on September 11, 2000. Fluor Corporation s executive offices are located at One Enterprise Drive, Aliso Viejo, California 92656, telephone number (949) 349-2000.

Recent Developments

On February 4, 2004, we announced financial results for the year ended December 31, 2003. Net earnings from continuing operations for the year ended December 31, 2003 were $179.5 million, or $2.23 per share (unaudited), compared with $170.0 million for the year ended December 31, 2002, or $2.13 per share. Revenues from continuing operations were $8.8 billion (unaudited) for the year ended December 31, 2003, compared with $10.0 billion for the year ended December 31, 2002.

New project awards in the fourth quarter and full year 2003 were $2.4 billion and $10.0 billion, respectively. This compares with $1.5 billion and $8.6 billion for the same periods a year ago, and represents an increase of 53% for new awards in the fourth quarter and 16% for the year. Consolidated backlog increased 9% to $10.6 billion from $9.7 billion at the end of last year and up from $10.3 billion at the end of the third quarter of this year.

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The Offering

Issuer	Fluor Corporation.
Securities Offered	$300,000,000 aggregate principal amount of 1.50% Convertible Senior Notes due 2024 ($330,000,000 aggregate principal amount if the underwriter s over-allotment option to purchase additional notes is exercised in full).
Maturity Date	February 15, 2024.
Ranking	The notes will be our senior unsecured obligations and will rank equally in right of payment with all of our existing and future senior unsecured obligations. At September 30, 2003, our senior indebtedness totaled approximately $144.4 million. The notes will not be guaranteed by any of our subsidiaries. Neither we nor our subsidiaries will be restricted under the indenture from incurring additional senior indebtedness or other additional indebtedness.
Interest	The notes will bear interest at a rate of 1.50% per year. We will pay interest on the notes on February 15 and August 15 of each year, beginning August 15, 2004.
Conversion Rights	Holders may not convert their notes prior to February 17, 2005. On or after February 17, 2005, holders may convert their notes prior to stated maturity, at their option, only under the following circumstances: during any fiscal quarter (and only during such fiscal quarter), if the closing price of our common stock for at least 20 trading days during the period of 30 consecutive trading days ending on the last trading day of the previous fiscal quarter is greater than or equal to 130% of the current conversion price of the notes on that 30th trading day; we have called the notes for redemption; or upon the occurrence of specified corporate transactions described under Description of the Notes Conversion Rights.
Conversion Rate	For each $1,000 principal amount of notes surrendered for conversion, a holder will receive 17.8750 shares of our common stock, equal to an initial conversion price of approximately $55.94 per share, subject to adjustment as set forth in Description of the Notes Conversion Rights Conversion Rate Adjustments. Upon conversion, we will have the right to deliver, in lieu of our common stock, cash or a combination of cash and shares of our common stock. At any time prior to maturity, we may irrevocably elect in our sole discretion to satisfy our conversion obligation in cash (as described under Description of the Notes Conversion Rights Payment Upon Conversion) up to 100% of the principal amount of the notes converted, with any remaining amount to be satisfied in shares of our common stock.

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	The conversion rate may be adjusted for certain reasons, including, generally, for cash dividends in excess of $0.16 per share per quarter. The conversion rate will not be adjusted for accrued and unpaid cash interest. Any accrued and unpaid cash interest will be deemed paid by the common stock or cash received by holders on conversion.
	Notes called for redemption may be surrendered for conversion until the close of business on the business day prior to the redemption date. See Description of the Notes Conversion Rights Payment Upon Conversion.
Sinking Fund	None.
Optional Redemption by Us	We may redeem some or all of the notes for cash at any time on or after February 16, 2009 at 100% of their principal amount, plus accrued and unpaid interest, if any, to but excluding each purchase date. See Description of the Notes Optional Redemption by Us.
Purchase of Notes by Us at the Option of the Holder	Holders of notes may require us to purchase all or a portion of their notes on February 15, 2009, February 15, 2014 and February 15, 2019 at 100% of their principal amount plus accrued and unpaid interest, if any, to but excluding each purchase date. We will pay the first put on February 15, 2009 in cash and subsequent puts on February 15, 2014 and February 15, 2019 in cash, stock or a combination thereof at our option. At any time prior to maturity, we may irrevocably elect in our sole discretion to satisfy 100% of the principal amount of the notes put to us after the date of such election in cash. See Description of the Notes Repurchase of Notes at the Option of the Holders.
Repurchase of the Notes at the Option of the Holder Upon a Fundamental Change	Upon a fundamental change (as defined under Description of the Notes Repurchase of the Notes at the Option of the Holders Upon a Fundamental Change), holders may require us to repurchase all or a portion of their notes for cash. We will pay a fundamental change repurchase price equal to 100% of the principal amount of such notes plus accrued and unpaid interest, if any, to but excluding the repurchase date. See Description of the Notes Repurchase of Notes at the Option of the Holders Upon a Fundamental Change.
United States Federal Income Tax Considerations	See Certain United States Federal Income Tax Considerations.
Use of Proceeds	We intend to use the net proceeds from this offering for working capital and general corporate purposes. See Use of Proceeds.
Form, Denomination and Registration	The notes will be issued in fully registered form. The notes will be issued in denominations of $1,000 principal amount and multiples thereof. The notes will be represented by one or more

	global notes, deposited with the trustee as custodian for The Depository Trust Company (DTC) and registered in the name of Cede & Co., DTC s nominee. Beneficial interests in the global notes will be shown on, and any transfers will be effected only through, records maintained by DTC and its participants. See Description of the Notes Form, Denomination and Registration.
Trading	We do not intend to list the notes on any national securities exchange. Our common stock is listed on the New York Stock Exchange under the symbol FLR.

You should read the Risk Factors section, beginning on page S-9 of this prospectus supplement, to understand the risks associated with an investment in the notes.

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Selected Consolidated Financial Data

The following table sets forth selected consolidated financial information regarding our operating results, financial position and other financial data and should be read in conjunction with the Management s Discussion and Analysis of Financial Condition and Results of Operations section and the consolidated financial statements and related notes incorporated by reference into this prospectus supplement. Our selected consolidated financial data for and as of the years ended December 31, 2002 and 2001 and October 31, 2000, and the two months ended December 31, 2000 are derived from our audited consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2002. Our selected consolidated financial data for and as of the nine months ended September 30, 2003 and 2002 are derived from our unaudited condensed consolidated financial statements contained in our Quarterly Report on Form 10-Q for the quarter ended September 30, 2003.

	Nine Months Ended September 30,		Year Ended December 31,		Year Ended October 31,	Two Months Ended December 31,
	2003	2002	2002	2001	2000	2000
	(in millions, except per share amounts)					
	(unaudited)					
Consolidated Operating Results						
Revenues	$ 6,441.2	$ 7,493.9	$ 9,959.0	$ 8,972.2	$ 9,422.9	$ 1,782.0
Earnings (loss) from continuing operations before taxes	191.8	194.2	260.5	185.3	164.3	(7.2)
Earnings (loss) from continuing operations	128.0	125.2	170.0	127.8	116.3	(4.1)
Earnings (loss) from discontinued operations	(11.6)	(9.8)	(6.4)	(108.4)	7.7	0.1
Cumulative effect of change in accounting principle	(10.4)					
Net earnings (loss)	106.0	115.4	163.6	19.4	124.0	(4.0)
Basic earnings (loss per share)						
Continuing operations	1.61	1.58	2.14	1.64	1.55	(0.05)
Discontinued operations	(0.15)	(0.13)	(0.08)	(1.39)	0.10	
Cumulative effect of change in accounting principle	(0.13)					
Net earnings (loss)	1.33	1.45	2.06	0.25	1.65	(0.05)
Diluted earnings (loss) per share						
Continuing operations	1.60	1.57	2.13	1.61	1.52	(0.05)
Discontinued operations	(0.15)	(0.13)	(0.08)	(1.36)	0.10	
Cumulative effect of change in accounting principle	(0.13)					
Net earnings (loss)	1.32	1.44	2.05	0.25	1.62	(0.05)
Return on average stockholders equity	16.6%	17.5%	19.4%	2.6%	7.7%	3.8%
Cash dividends per common share	0.48	0.48	0.64	0.64	1.00	
Other Data						
New awards	$ 7,622.6	$ 7,060.4	$ 8,596.8	$ 10,766.6	$ 9,644.2	$ 1,037.1
Backlog at end of period	10,303.8	10,852.0	9,709.1	11,505.5	10,012.2	9,766.7
Capital expenditures continuing operations	47.6	51.0	63.0	148.4	156.2	29.8
Cash provided by (used in) operating activities	$ (143.6)	$ 243.7	$ 206.9	$ 614.7	$ 186.1	$ (67.6)

	As of September 30,	As of December 31,		As of October 31,	As of December 31,
	2003	2002	2001	2000	2000
	(unaudited)	(in millions, except per share amounts)			
Consolidated Financial Position					
Current assets	$2,055.3	$1,924.1(1)	$1,851.3	$1,318.3	$1,230.7
Current liabilities	1,654.3	1,756.2	1,862.7	1,570.3	1,604.1
Working capital	401.0	167.9	(11.4)	(252.0)	(373.4)
Property, plant and equipment, net[2]	561.6	467.0	508.1	570.8	573.0
Total assets	3,287.5	3,142.2	3,142.5	4,958.4	2,700.6
Capitalization					
Short-term debt[3]			38.4	88.7	227.6
Long-term debt[2]	144.4	17.6	17.6	17.6	17.6
Stockholders equity	1,015.0	883.9	789.3	1,609.2	633.1
Total capitalization	1,159.4	901.5	845.3	1,715.5	878.3
Total debt as a percent of total capitalization	12.5%	2.0%	6.6%	6.2%	27.9%
Stockholders equity per common share	12.40	11.02	9.85	21.25	8.49
Common shares outstanding at period end	81.9	80.2	80.1	75.7	74.6

(1) Reflects reclassification of certain amounts to conform to the 2003 basis of presentation.

(2) Pursuant to the requirements of FASB Interpretation No. 46, Consolidation of Variable Interest Entities, we have consolidated, for September 30, 2003, the Property, Plant and Equipment and the long-term debt of two entities that own certain engineering office facilities, which are leased to us. We have no ownership interest in the companies that own the facilities but are deemed to be the primary beneficiary of the variable interests in these entities.

(3) Includes commercial paper, loan notes, miscellaneous trade notes payable and the current portion of long-term debt.

During fiscal years 2002 and 2003, we disposed of certain non-core construction equipment and temporary staffing businesses. The assets and liabilities (including debt) and results of operations of Massey Energy Company and the non-core businesses for all periods presented have been reclassified and are presented as discontinued operations. In addition, we changed to a calendar-year basis of reporting financial results in connection with the reverse spin-off transaction.

RISK FACTORS

You should carefully consider the risks described below before making an investment decision. The risks and uncertainties described below are not the only ones facing our company. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our business operations.

If any of the following risks actually occurs, our business, financial condition or results of operations could be materially adversely affected. In that case, the trading price of the notes and our common stock could decline substantially.

This prospectus supplement also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of a number of factors, including the risks described below and elsewhere in this prospectus supplement.

Risks Related to Our Business

We bear the risk of cost overruns in approximately 37% of the dollar-value of our contracts. We may experience reduced profits or, in some cases, losses under these contracts if costs increase above our estimates.

We conduct our business under various types of contractual arrangements. In terms of dollar-value, the majority of our contracts allocate the risk of cost overruns to our client by requiring our client to reimburse us for our costs. Approximately 37% of the dollar-value of our contracts, however, are guaranteed maximum or lump sum contracts, where we bear a significant portion of the risk for cost overruns. Under these fixed-price contracts, contract prices are established in part on cost and scheduling estimates which are based on a number of assumptions, including assumptions about future economic conditions, prices and availability of labor, equipment and materials, and other exigencies. If these estimates prove inaccurate, or circumstances change, cost overruns may occur, and we could experience reduced profits or, in some cases, a loss for that project.

Our backlog is subject to unexpected adjustments and cancellations and is, therefore, an uncertain indicator of our future earnings.

As of September 30, 2003, our backlog was approximately $10.3 billion. We cannot guarantee that the revenues projected in our backlog will be realized or, if realized, will result in profits. Projects may remain in our backlog for an extended period of time. In addition, project cancellations, scope adjustments or changes in our corporate strategy may occur, from time to time, and may impact contracts reflected in our backlog. For example, during our third quarter in fiscal 2003, three projects totaling approximately $750 million were removed from our backlog. One of the projects was cancelled and removed from backlog as a result of financing difficulties; the other two projects were cancelled and removed from backlog as a result of our strategic decision to exit a particular market. These types of backlog reductions adversely affect the revenue and profit we actually receive from contracts reflected in our backlog. Future project cancellations and scope adjustments could further reduce the dollar amount of our backlog and the revenues and profits that we actually receive.

If we guarantee the timely completion or performance standards of a project, we could incur additional costs to cover our guarantee obligations.

In some instances and in many of our fixed-price contracts, we guarantee a customer that we will complete a project by a scheduled date. We sometimes provide that the project, when completed, will also achieve certain performance standards. If we subsequently fail to complete the project as scheduled, or if the project subsequently fails to meet guaranteed performance standards, we may be held responsible for cost impacts to the client resulting from any delay or the costs to cause the project to achieve the

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performance standards. In some cases, where we fail to meet performance standards, we may also be subject to agreed-upon liquidated damages. To the extent that these events occur, the total costs of the project would exceed our original estimates and we could experience reduced profits or, in some cases, a loss for that project.

The nature of our engineering and construction business exposes us to potential liability claims and contract disputes which may reduce our profits.

We engage in engineering and construction activities for large industrial facilities where design, construction or systems failures can result in substantial injury or damage to third parties. Any liability in excess of our insurance limits at locations engineered or constructed by us could result in significant liability claims against us, which claims may reduce our profits. In addition, if there is a customer dispute regarding our performance of project services, the customer may decide to delay or withhold payment to us. If we were ultimately unable to collect on these payments, our profits would be reduced. For example, in connection with disputes relating to our Hamaca Crude Upgrader Project, we had deferred approximately $139.5 million of incurred costs, as of September 30, 2003. If we fail to obtain a favorable judgment or are unable to collect on any awards from a favorable judgment in connection with the Hamaca disputes, our profits and financial condition could be materially and adversely affected.

We are vulnerable to the cyclical nature of the markets we serve.

The demand for our services and products is dependent upon the existence of projects with engineering, procurement, construction and management needs. Although downturns can impact our entire business, our telecommunications and mining markets exemplify businesses that are cyclical in nature and continue to be affected by a decrease in worldwide demand for the projects during the past year. Similarly, the Power segment, which services the power industry, has seen strong growth in the past few years due to previously unmet power needs and deregulation but is now seeing its business opportunities decrease relative to the last few years. Industries such as these and many of the others we serve have historically been and will continue to be vulnerable to general downturns and are cyclical in nature. As a result, our past results have varied considerably and may continue to vary depending upon the demand for future projects in these industries.

We maintain a workforce based upon current and anticipated workloads. If we do not receive future contract awards or if these awards are delayed, significant costs may result.

Our estimates of future performance depend on, among other matters, whether and when we will receive certain new contract awards. While our estimates are based upon our good faith judgment, these estimates can be unreliable and may frequently change based on newly available information. In the case of large-scale domestic and international projects where timing is often uncertain, it is particularly difficult to predict whether and when we will receive a contract award. The uncertainty of contract award timing can present difficulties in matching our workforce size with our contract needs. If an expected contract award is delayed or not received, we could incur costs resulting from reductions in staff or redundancy of facilities that would have the effect of reducing our profits.

We have international operations that are subject to foreign economic and political uncertainties. Unexpected and adverse changes in the foreign countries in which we operate could result in project disruptions, increased costs and potential losses.

Our business is subject to fluctuations in demand and to changing domestic and international economic and political conditions which are beyond our control. As of September 30, 2003, approximately 40% of our projected backlog consisted of engineering and construction revenues to be derived from facilities to be constructed in other countries; we expect that a significant portion of our revenues and profits will continue to come from international projects for the foreseeable future.

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Operating in the international marketplace exposes us to a number of risks including:

- abrupt changes in foreign government policies and regulations,
- embargoes,
- U.S. government policies, and
- international hostilities.

The lack of a well-developed legal system in some of these countries may make it difficult to enforce our contractual rights. We also face significant risks due to civil strife, acts of war, terrorism and insurrection. For example, we may receive contracts for reconstruction work in Iraq, which could entail significant risks relating to each of the aforementioned matters. Our level of exposure to these risks will vary with respect to each project, depending on the particular stage of each such project. Generally, our risk exposure with respect to a project in an early development stage will be less than our risk exposure with respect to a project in the middle of construction. To the extent that our international business is affected by unexpected and adverse foreign economic and political conditions, we may experience project disruptions and losses. Any project disruptions and losses could significantly reduce our revenues and profits.

Our government contracts may be terminated at any time. Also, if we do not comply with restrictions and regulations imposed by the government, our government contracts may be terminated and we may be unable to enter into future government contracts. The termination of our government contracts could significantly reduce our expected revenues.

We enter into significant government contracts, from time to time, such as those that we have with the U.S. Department of Energy at Fernald and Hanford. Government contracts are subject to various uncertainties, restrictions and regulations, including oversight audits by government representatives and profit and cost controls. Government contracts are also exposed to uncertainties associated with congressional funding. The government is under no obligation to maintain funding at any specific level and funds for a program may even be eliminated.

In addition, government contracts are subject to specific procurement regulations and a variety of other socio-economic requirements. We must comply with these government regulations and requirements as well as various statutes related to employment practices, environmental protection, recordkeeping and accounting. If we fail to comply with any of these regulations, requirements or statutes, our existing government contracts could be terminated, and we could be temporarily suspended from government contracting or subcontracting. If one or more of our government contracts are terminated for any reason, or if we are suspended from government contract work, we could suffer a significant reduction in expected revenues.

Our international operations expose us to foreign currency fluctuations that could increase our U.S. dollar costs or reduce our U.S. dollar revenues.

Because our functional currency is the U.S. dollar, we try to denominate our contracts in U.S. dollars. However, from time to time our contracts are denominated in foreign currencies, which results in our foreign operations facing the additional risk of fluctuating currency values and exchange rates, hard currency shortages and controls on currency exchange. Changes in the value of foreign currencies could increase our U.S. dollar costs for, or reduce our U.S. dollar revenues from, our foreign operations. Any increased costs or reduced revenues as a result of foreign currency fluctuations could affect our profits.

Our recent and any future acquisitions may be difficult to integrate, may underperform or may not otherwise be successful.

We recently completed, and expect to continue to pursue, select acquisitions of businesses. We cannot, however, provide any assurance that we will be able to complete any additional acquisitions or that

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any acquisitions that we have completed or may complete will enhance our business. Our recently completed acquisitions and the acquisitions that we may complete in the future could subject us to a number of risks, including:

- diversion of our management s attention;
- inability to integrate the acquired business and its employees into our organization effectively and to retain key personnel of the acquired business;
- inability to provide the required types and levels of service to the acquired business s customers;
- inability to retain the acquired business s customers; and
- exposure to legal claims for activities of the acquired business prior to acquisition.

Future acquisitions may bring us into businesses we have not previously conducted and expose us to additional business risks that are different than those we have traditionally experienced. Client satisfaction or performance problems with an acquired business could adversely affect our reputation as a whole. In addition, any acquired business could significantly underperform relative to our expectations.

Intense competition in the engineering and construction industry could reduce our market share and profits.

We serve markets that are highly competitive and in which a large number of multinational companies, such as the Bechtel Group, the Shaw Group, Jacobs Engineering Group, Kellogg Brown & Root, Washington Group International and Foster Wheeler, compete. In particular, the engineering and construction markets are highly competitive and require substantial resources and capital investment in equipment, technology and skilled personnel. Competition also places downward pressure on our contract prices and profit margins. Intense competition is expected to continue in these markets, presenting us with significant challenges in our ability to maintain strong growth rates and acceptable profit margins. If we are unable to meet these competitive challenges, we could lose market share to our competitors and experience an overall reduction in our profits.

The success of our joint ventures depends on the satisfactory performance by our joint venture partners of their joint venture obligations. The failure of our joint venture partners to perform their joint venture obligations could impose on us additional financial and performance obligations that could result in reduced profits or, in some cases, significant losses for us with respect to the joint venture.

We enter into various joint ventures as part of our engineering, procurement and construction businesses, such as ICA/ Fluor Daniel and Duke/ Fluor Daniel. The success of these and other joint ventures depend, in large part, on the satisfactory performance of our joint venture partners of their joint venture obligations. If our joint venture partners fail to satisfactorily perform their joint venture obligations as a result of financial or other difficulties, the joint venture may be unable to adequately perform or deliver its contracted services. Under these circumstances, we may be required to make additional investments and provide additional services to ensure the adequate performance and delivery of the contracted services. These additional obligations could result in reduced profits or, in some cases, significant losses for us with respect to the joint venture.

We could incur substantial tax liabilities if certain representations and warranties made by our predecessor-in-interest are inaccurate.

Prior to the reverse spin-off, our predecessor-in-interest received a ruling from the Internal Revenue Service that the reverse spin-off qualified as a tax-free spin-off under Section 355 of the Internal Revenue Code of 1986. The ruling was granted based upon certain representations made by our predecessor-in-interest. While we are not aware of any facts or circumstances that would cause those representations to be incorrect or incomplete, if those representations were inaccurate, it is possible that the ruling would no

longer be valid. In such event, we could incur a significant corporate tax liability that could have a material adverse effect on our financial condition.

Environmental, safety and health regulations could impose on us significant additional costs that reduce our profits.

We are subject to numerous environmental laws and health and safety regulations. Our projects involve the handling of hazardous and other highly regulated materials which could subject us to civil and criminal liabilities. It is impossible to reliably predict the full nature and effect of judicial, legislative or regulatory developments relating to health and safety regulations and environmental protection regulations applicable to our operations. The applicable regulations, as well as the technology and length of time available to comply with those regulations, continue to develop and change. In addition, past activities could also have a material impact on us. For example, when we sold our mining business formerly conducted through St. Joe Minerals Corporation, we retained responsibility for certain non-lead related environmental liabilities, but only to the extent that such liabilities were not covered by St. Joe s comprehensive general liability insurance. While we are not currently aware of any material exposure arising from our former St. Joe s business or otherwise, the costs of complying with rulings and regulations or satisfying any environmental remediation requirements for which we are found responsible, or any potential fines or penalties imposed for our failure to fully comply with such rulings or regulations, could be substantial and could reduce our profits. We are also subject to a number of asbestos-related lawsuits.

If we experience delays and/or defaults in customer payments, we could be unable to recover all expenditures.

Because of the nature of our contracts, at times we commit resources to projects prior to receiving payments from the customer in amounts sufficient to cover expenditures on client projects as they are incurred. Delays in customer payments may require us to make a working capital investment. If a customer defaults in making its payments on a project in which we have devoted significant resources, it could have a material negative effect on our results of operations.

Risks Related to the Notes

Servicing the debt represented by the notes will require a significant amount of cash, and our ability to generate sufficient cash depends on many factors, some of which are beyond our control.

Our ability to make payments on the notes, other debt we may incur in the future and our ability to fund our corporate strategy depends on our ability to generate cash flow. Our ability to generate cash flow in the future is, to some extent, subject to general economic, financial, competitive, legislative and regulatory factors and other factors that are beyond our control. We cannot assure you that our business will generate sufficient cash from operations or that our future access to capital will be sufficient to enable us to pay our debt, including the notes, or to fund our other liquidity needs.

At maturity, the entire outstanding principal amount of the notes will become due and payable by us. In addition, each holder of the notes may require us to repurchase all or a portion of that holder s notes as specified under Description of the Notes Repurchase of Notes at the Option of the Holder or, if a fundamental change, as defined in the indenture, occurs. A fundamental change also may constitute an event of default under, and result in the acceleration of the maturity of, indebtedness under another indenture or other indebtedness that we have or may incur in the future.

Any inability on our part to generate sufficient cash flow or raise capital on favorable terms could have a material adverse effect on our financial condition and on our ability to make payments on the notes.

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The notes will be effectively subordinated to existing and future indebtedness of our subsidiaries.

Because we operate primarily through our subsidiaries, we derive our revenues from and hold our assets through, those subsidiaries. As a result, we rely upon distributions and advances from our subsidiaries in order to meet our payment obligations under the notes and our other obligations. In general, these subsidiaries are separate and distinct legal entities and will have no obligation to pay any amounts due on our debt securities, including the notes, or to provide us with funds for our payment obligations, whether by dividends, distributions, loans or otherwise. Our right to receive any assets of any subsidiary in the event of a bankruptcy or liquidation of the subsidiary, and therefore the right of our creditors to participate in those assets, will be effectively subordinated to the claims of that subsidiary s creditors, including trade creditors. As of September 30, 2003, our subsidiaries had no outstanding indebtedness, excluding intercompany indebtedness, but had substantial trade payables of approximately $567.1 million.

The trading prices for the notes will be directly affected by the trading prices for our common stock, which are impossible to predict.

The price of our common stock could be affected by possible sales of our common stock by investors who view the notes as a more attractive means of equity participation in our company and by hedging or arbitrage trading activity that may develop involving our common stock. The hedging or arbitrage could, in turn, affect the trading prices of the notes.

A downgrade, suspension or withdrawal of the rating assigned by a rating agency to the notes would cause the liquidity or market value of the notes to decline significantly.

The notes have been rated BBB+ by Standard & Poor s and A3 by Moody s. There can be no assurance that these ratings will remain for any given period of time or that a rating will not be lowered or withdrawn entirely by a rating agency. As a result, the market price of the notes could be adversely affected.

There may be no public market for the notes.

Prior to this offering, there has been no trading market for the notes. We do not intend to apply for listing of the notes on any securities exchange or any automated quotation system. Although the underwriters have advised us that they currently intend to make a market in the notes, they are not obligated to do so and may discontinue their market-making activities at any time without notice. Consequently, we cannot be sure that any market for the notes will develop, or if one does develop, that it will be maintained. If an active market for the notes fails to develop or be sustained, the trading price and liquidity of the notes could be adversely affected.

The conditional conversion feature of the notes could result in you not receiving the value of the common stock into which the notes are convertible.

The notes are convertible into common stock only if specific conditions are met. If the specific conditions for conversion are not met, you may not be able to receive the value of the common stock into which your notes would otherwise be convertible.

The conversion rate of the notes may not be adjusted for all dilutive events.

The conversion rate of the notes is subject to adjustment for certain events, including but not limited to the issuance of stock dividends on our common stock, the issuance of certain rights or warrants, subdivisions or combinations of our common stock, distributions of capital stock, indebtedness or assets, certain cash dividends and certain tender or exchange offers as described under Description of the Notes Conversion Rights Conversion Rate Adjustments. The conversion rate will not be adjusted for other events, such as an issuance of common stock for cash, that may adversely affect the trading price of the notes or the common stock. There can be no assurance that an event that adversely affects the value of the notes, but does not result in an adjustment to the conversion rate, will not occur.

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The value of the conversion rights associated with the notes may be substantially lessened or eliminated if we are a party to a merger, consolidation or similar transaction.

If we are a party to a consolidation, merger or transfer or lease of all or substantially all of our assets pursuant to which our common stock would be converted to cash, securities or other assets, the notes would become convertible into such cash, securities or other amounts. As a result, the value of the conversion rights associated with the notes may be substantially lessened or eliminated because you would no longer be able to convert your notes into shares of our common stock in the future or because of changes in the nature or volatility of our common stock. See Description of Notes Conversion Rights.

You may have to pay taxes with respect to distributions on our common stock that you do not receive.

The conversion rate of the notes is subject to adjustment for certain events arising from stock splits and combinations, stock dividends, certain cash dividends and certain other actions by us that modify our capital structure. See Description of the Notes Conversion Rights Conversion Rate Adjustments. If the conversion rate is adjusted as a result of a distribution that is taxable to our common stockholders, such as a cash dividend in excess of $0.16 per share per quarter, you would be required to include an amount in income for federal income tax purposes, notwithstanding the fact that you do not actually receive such distribution. In addition, Non-U.S. Holders of notes may, in certain circumstances, be deemed to have received a distribution subject to U.S. federal withholding tax requirements. See Certain United States Federal Income Tax Considerations.

The notes do not restrict our and our subsidiaries ability to incur additional debt or to take other action that could negatively impact holders of the notes.

We and our subsidiaries are not restricted under the terms of the indenture and the notes from incurring additional indebtedness or securing indebtedness other than the notes. In addition, the notes do not require us to achieve or maintain any minimum financial results relating to our financial position or results of operations. Our ability to recapitalize, incur additional debt, secure existing or future debt and take a number of other actions that are not limited by the terms of the indenture and the notes could have the effect of diminishing our ability to make payments on the notes when due. In addition, we and our subsidiaries are not restricted from repurchasing subordinated indebtedness or common stock by the terms of the indenture and the notes.

If you hold notes, you will not be entitled to any rights with respect to our common stock, but you will be subject to all changes made with respect to our common stock.

If you hold notes, you will not be entitled to any rights with respect to our common stock (including, without limitation, voting rights and rights to receive any dividends or other distributions on our common stock), but you will be subject to all changes affecting the common stock. You will have rights with respect to our common stock only if and when we deliver shares of common stock to you upon conversion of your notes and, in limited cases, under the conversion rate adjustments applicable to the notes. For example, in the event that an amendment is proposed to our amended and restated certificate of incorporation or bylaws requiring stockholder approval and the record date for determining the stockholders of record entitled to vote on the amendment occurs prior to delivery of common stock to you, you will not be entitled to vote on the amendment, although you will nevertheless be subject to any changes in the powers, preferences or special rights of our common stock.

We have various mechanisms in place to discourage takeover attempts, which may reduce or eliminate our stockholders ability to sell their shares for a premium in a change of control transaction.

Various provisions of our amended and restated certificate of incorporation and bylaws and of Delaware corporate law may discourage, delay or prevent a change in control or takeover attempt of our company by a third party that is opposed to by our management and board of directors. Public stockholders who might desire to participate in such a transaction may not have the opportunity to do so.

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These anti-takeover provisions could substantially impede the ability of public stockholders to benefit from a change of control or change in our management and board of directors. These provisions include:

authorization for our board of directors to issue preferred stock, without further vote or action by the stockholders, which could make it more difficult for a third party to acquire, or discourage a third party from acquiring, a majority of our outstanding voting stock;

classification of our board of directors into three classes of directors serving staggered three-year terms;

non-cumulative voting for directors;

the ability of our board of directors to increase the size of our board and to fill vacancies on our board;

prohibition on stockholders calling a meeting or acting by written consent; and

requirements for advance notice for raising business or making nominations at stockholder meetings.

USE OF PROCEEDS

We estimate that the net proceeds to us from the sale of the notes will be approximately $293,100,000, net of expenses ($322,500,000 if the underwriters over-allotment option to purchase additional notes is exercised in full). We expect to use the net proceeds for working capital and general corporate purposes. Pending their use, we intend to invest the net proceeds of this offering primarily in short-term, investment-grade, interest-bearing instruments and in U.S. government debt securities and high-grade investment quality debt securities with maturities of less than three years.

RATIO OF EARNINGS TO FIXED CHARGES

Our ratios of earnings to fixed charges for each of the nine months ended September 30, 2003, the two years ended December 31, 2002 and 2001 and the three years ended October 31, 2000, 1999 and 1998 are as follows:

Nine Months Ended September 30,	Year Ended December 31,		Year Ended October 31,		
2003	2002	2001	2000	1999	1998
7.88	8.26	4.80	4.10	2.86	5.50

For purposes of computing the ratio of earnings to fixed charges, earnings consist of earnings from continuing operations before provision for income taxes plus fixed charges less equity in earnings from less than 50% owned persons, net of distributions. Fixed charges consist of interest and approximately one-third of rental expense. You should also refer to the Management s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2002 and our Quarterly Report on Form 10-Q for the quarter ended September 30, 2003 for a discussion of factors which have affected our earnings from continuing operations before income taxes.

PRICE RANGE OF COMMON STOCK

Our common stock is traded on the New York Stock Exchange under the symbol FLR. The following table sets forth for the quarters indicated, since our reverse spin-off transaction on November 30, 2000, the high and low closing prices of our common stock and the cash dividends paid per share of common stock.

	Common Stock Price Range		Dividends Per Share
	High	Low	
Year Ended December 31, 2003			
Fourth Quarter	$40.54	$34.60	$0.16
Third Quarter	$37.83	$32.80	$0.16
Second Quarter	$36.48	$33.20	$0.16
First Quarter	$34.99	$27.18	$0.16
Year Ended December 31, 2002			
Fourth Quarter	$28.42	$20.94	$0.16
Third Quarter	$37.66	$24.00	$0.16
Second Quarter	$44.57	$35.46	$0.16
First Quarter	$43.91	$29.59	$0.16
Year Ended December 31, 2001			
Fourth Quarter	$46.98	$35.40	$0.16
Third Quarter	$45.49	$35.30	$0.16
Second Quarter	$62.65	$40.97	$0.16
First Quarter	$46.84	$31.82	$0.16

DIVIDEND POLICY

For each of the four quarters for the years ended December 31, 2001, 2002 and 2003, we have paid a $0.16 per share cash dividend. We expect to pay comparable dividends in the future. However, any future cash dividends will depend upon our results of operations, financial condition, cash requirements, availability of surplus and such other factors as our board of directors may deem relevant. See Risk Factors.

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CAPITALIZATION

The following table sets forth our consolidated capitalization, as of September 30, 2003 and as adjusted for the sale of the notes offered hereby.

	Actual[1]	As Adjusted
	(Unaudited) ($ in thousands)	
Long-term debt due after one year:		
5.625% Municipal bonds	$ 17,626	$ 17,626
Facilities financing[2]	126,734	126,734
Convertible senior notes due 2024		300,000
Total long-term debt due after one year	144,360	444,360
Stockholders equity	1,015,018	1,015,018
Total capitalization	$1,159,378	$1,459,378

(1) See the notes to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2002 for additional information relating to long-term debt and capital stock.

(2) Pursuant to the requirements of FASB Interpretation No. 46, Consolidation of Variable Interest Entities, we have consolidated long-term debt of two entities that own certain engineering office facilities, which are leased to us. We have no ownership interest in the companies that own the facilities but are deemed to be the primary beneficiary of the variable interests in these entities.

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DESCRIPTION OF THE NOTES

We will issue the notes under an indenture, dated as of February 17, 2004, between us and The Bank of New York, a New York banking corporation, as trustee, as amended by a supplemental indenture between us and the trustee. Initially, the trustee will also act as paying agent, conversion agent and calculation agent for the notes. The terms of the notes include those provided in the indenture.

The following description is only a summary of the material provisions of the notes and the indenture and is subject to, and is qualified in its entirety by reference to, the detailed provisions of the notes and the indenture. We urge you to read the notes and the indenture in their entirety because they, and not this description, define your rights as holders of the notes.

When we refer to Fluor, Fluor Corporation, us, we, or our in this section, we refer only to Fluor Corporation, a Delaware corporation, and not its subsidiaries.

Brief Description of the Notes

The notes offered hereby will:

- be $300,000,000 in aggregate principal amount of notes ($330,000,000 if the underwriters over-allotment option to purchase additional notes is exercised in full);
- bear cash interest at a rate of 1.50% per annum payable on each February 15 and August 15 of each year, beginning August 15, 2004;
- be senior unsecured obligations of Fluor Corporation, ranking equally with all of our other senior unsecured obligations; as indebtedness of Fluor Corporation, the notes will be effectively subordinated to all indebtedness and liabilities of our subsidiaries;
- be convertible, subject to the conditions described under Conversion Rights, into our common stock at a conversion rate of 17.8750 shares per $1,000 principal amount of notes (equivalent to a conversion price of approximately $55.94 per share), subject to such adjustments as are described under Conversion Rights Conversion Rate Adjustments ;
- permit us to satisfy our conversion obligation in cash, shares of our common stock or a combination of cash and shares of common stock;
- be redeemable at our option in whole or in part for cash beginning on February 16, 2009, as set forth under Optional Redemption by Us ;
- entitle you to require us to repurchase the notes on February 15, 2009, February 15, 2014 and February 15, 2019, as set forth under Repurchase of Notes at the Option of the Holders ;
- entitle you to require us to repurchase for cash the notes upon a fundamental change as set forth under Repurchase of Notes at the Option of the Holders Upon a Fundamental Change ;
- be due on February 15, 2024, unless earlier converted, redeemed by us at our option or repurchased by us at your option;
- be offered and sold at 100% of their principal amount;
- be issued only in registered form, without coupons, in denominations of $1,000 principal amount and multiples thereof; and
- not have a sinking fund.

The indenture does not contain any financial covenants and does not restrict us from paying dividends, incurring additional indebtedness or issuing or repurchasing our other securities. The indenture also does not protect you in the event of a highly leveraged transaction or a change of control of Fluor Corporation, except to the extent described under Repurchase of Notes at the Option of the Holders Upon a Fundamental Change below.

You may present definitive notes for conversion, registration of transfer and exchange at our office or agency in New York City, which shall initially be the principal corporate trust office of the trustee currently located at 101 Barclay Street 8W, New York, New York 10286, Attention: Corporate Trust

Administration. For information regarding conversion, registration of transfer and exchange of global notes, see Form, Denomination and Registration. No service charge will be made for any registration of transfer or exchange of notes, but we may require payment of a sum sufficient to cover any tax or other governmental charge payable in connection therewith.

Ranking

The notes will be our senior unsecured obligations and will rank equally in right of payment with all of our existing and future senior unsecured obligations. At September 30, 2003, our senior indebtedness totaled approximately $144.4 million. The notes will not be guaranteed by any of our subsidiaries and, accordingly, the notes are effectively subordinated to the indebtedness and other liabilities of our subsidiaries, including trade creditors. As of September 30, 2003, our subsidiaries had no outstanding indebtedness, excluding intercompany indebtedness, but had substantial trade payables of approximately $567.1 million. Neither we nor our subsidiaries will be restricted under the indenture from incurring additional senior indebtedness or other additional indebtedness.

Interest

The notes will bear interest at a rate of 1.50% per annum from February 17, 2004.

We will pay interest semiannually on February 15 and August 15 of each year, beginning August 15, 2004, to the holders of record at the close of business on the preceding February 1 and August 1, respectively; provided that interest payable upon redemption will be paid to the person to whom principal is payable, unless the redemption date is an interest payment date. In general, we will not pay accrued and unpaid interest on any notes that are converted into our common stock. Instead, accrued interest will be deemed paid by the common stock received by holders on conversion.

Except as provided below, we will pay interest on:

- global notes to The Depository Trust Company, or DTC, in immediately available funds;

- any definitive notes having an aggregate principal amount of $5,000,000 or less by check mailed to the holders of those notes; and

- any definitive notes having an aggregate principal amount of more than $5,000,000 by wire transfer in immediately available funds if requested by the holders of those notes.

At maturity we will pay interest on the definitive notes at our office or agency in New York City which initially will be the principal corporate trust office of the trustee. We will make payments of interest at maturity on global notes to DTC, in immediately available funds.

Interest on the notes will be computed on the basis of a 360-day year comprised of twelve 30-day months.

If any interest payment date (other than an interest payment date coinciding with the stated maturity date or earlier redemption date, purchase date or fundamental change purchase date) of a note falls on a day that is not a business day, such interest payment date will be postponed to the next succeeding business day, provided that, if such business day falls in the next succeeding calendar month, the interest payment date will be brought forward to the immediately preceding business day. If the stated maturity date, redemption date, purchase date or fundamental change purchase date of a note would fall on a day that is not a business day, the required payment of interest, if any, and principal will be made on the next succeeding business day and no interest on such payment will accrue for the period from and after the stated maturity date, redemption date or purchase date to such next succeeding business day. The term business day means, with respect to any note, any day other than a Saturday, a Sunday or a day on which banking institutions in New York City or the place of payment are authorized or required by law, regulation or executive order to close.

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Conversion Rights

General

Holders may not convert their notes prior to February 17, 2005. On or after February 17, 2005 and subject to the conditions and during the periods described below, holders may convert their notes at any time prior to the close of business on the maturity date into shares of our common stock. For each $1,000 principal amount of notes surrendered for conversion, a holder will receive 17.8750 shares of our common stock, equal to an initial conversion price of approximately $55.94, subject to adjustment as set forth in Conversion Rate Adjustments below.

We will not issue fractional shares of common stock upon conversion of the notes. Instead, we will pay cash in lieu of fractional shares. The cash amount to be paid for all fractional shares of common stock will be based on the closing price of our common stock immediately preceding the conversion date. You may convert notes only in denominations of $1,000 principal amount and multiples thereof.

If a holder converts after a record date for an interest payment but prior to the corresponding interest payment date, the holder of record on the preceding record date will receive on that interest payment date accrued and unpaid interest on those notes, notwithstanding the holder s conversion of those notes prior to that interest payment date. However, at the time of such a conversion, the holder surrendering notes for conversion must pay to us an amount equal to the interest that will be paid on the related interest payment date. The preceding sentence does not apply, however, if (1) we have specified a redemption date that is after a record date for an interest payment but on or prior to the corresponding interest payment date, (2) we have specified a repurchase date following a fundamental change that is during such period or (3) any overdue interest exists at the time of conversion with respect to the notes converted only to the extent of the overdue interest. Accordingly, under those circumstances, a holder who chooses to convert those notes on a date that is after a record date but prior to the corresponding interest payment date, will not be required to pay us, at the time that holder surrenders those notes for conversion, the amount of interest it will receive on the interest payment date.

Any notes called for redemption must be surrendered for conversion prior to the close of business on the business day prior to the redemption date. If the holder has exercised its right to require us to repurchase its notes as described under Repurchase of Notes at the Option of Holders or Repurchase of Notes at the Option of the Holders Upon a Fundamental Change, the holder may convert its notes into our common stock only if it withdraws its purchase notice or fundamental change repurchase notice, as the case may be.

Upon conversion, we may choose to deliver, in lieu of shares of our common stock, cash or a combination of cash and shares of our common stock, as described below under Payment Upon Conversion. At any time prior to maturity, we may irrevocably elect in our sole discretion to satisfy our conversion obligation in cash (as described under Payment Upon Conversion) up to 100% of the principal amount of the notes converted, with any remaining amount to be satisfied in shares.

To convert a note (other than a note held in book-entry form through DTC) into common stock a holder must:

- complete and manually sign the conversion notice on the back of the note or facsimile of the conversion notice and deliver this notice to the conversion agent;
- surrender the note to the conversion agent;
- if required, furnish appropriate endorsements and transfer documents;
- if required, pay all transfer or similar taxes; and
- if required, pay funds equal to interest payable on the next interest payment date, to which the holder is not entitled, as described in Interest.

Holders of notes held in book-entry form through DTC must comply with the requirements in the last three bullets above and follow DTC s customary practices. The date the holder complies with these

requirements is the conversion date under the indenture. Settlement of our obligation to deliver shares and cash (if any) with respect to a conversion will occur on the dates described under Payment Upon Conversion below. Delivery of shares will be accomplished by delivery to the conversion agent or to holders or their nominees of certificates for the relevant number of shares, other than in the case of holders of notes in book-entry form with DTC, which shares shall be delivered in accordance with DTC s customary practices. In addition, we will pay cash for any fractional shares, as described above.

If a holder delivers a note for conversion, it will not be required to pay any taxes or duties for the issue or delivery of common stock on conversion. However, we will not pay any transfer tax or duty payable as a result of the issuance or delivery of the common stock in a name other than that of the holder of the note. We will not issue or deliver common stock certificates unless we have been paid the amount of any transfer tax or duty or we have been provided satisfactory evidence that the transfer tax or duty has been paid.

By delivering to the holder the number of shares or the amount of cash determined as set forth below under Payment Upon Conversion, together with cash in lieu of any fractional shares, we will satisfy our obligation with respect to the notes. That is, accrued and unpaid interest, if any, will be deemed to be paid in full rather than cancelled, extinguished or forfeited, except as set forth above under Interest.

Payment Upon Conversion

Conversion on or Prior to the Final Notice Date

In the event that we receive your notice of conversion on or prior to the date that is 10 days prior to maturity or, with respect to notes being redeemed, the applicable redemption date (the final notice date), the following procedures will apply:

If we choose to satisfy all or any portion of our obligation to deliver common stock upon conversion (the conversion obligation) in cash, we will notify you through the trustee of the dollar amount to be satisfied in cash (which must be expressed either as 100% of the conversion obligation or as a fixed dollar amount) at any time on or before the date that is two business days following receipt by the conversion agent of your notice of conversion (the cash settlement notice period). If we timely elect to pay cash for any portion of the shares otherwise issuable to you, you may retract the conversion notice at any time during the two business day period beginning on the day after the final day of the cash settlement notice period (the conversion retraction period). If we do not elect to deliver cash in lieu of shares (other than cash in lieu of fractional shares), no such retraction can be made (and a conversion notice shall be irrevocable). If we elect to deliver cash for all or a portion of the shares and if the conversion notice has not been retracted, then settlement (in cash and/or shares) will occur on the third business day following the final day of the 10 trading day period beginning on the day after the final day of the conversion retraction period (the cash settlement averaging period). If we choose to satisfy the entire conversion obligation in shares of our common stock, then settlement will occur on the third business day following the conversion date. Settlement amounts will be computed as follows:

If we elect to satisfy the entire conversion obligation in shares, we will deliver to you a number of shares for each $1,000 principal amount of notes to be converted equal to the conversion rate. In addition, we will pay cash for all fractional shares of common stock as described above under General.

If we elect to satisfy the entire conversion obligation in cash, we will deliver to you for each $1,000 principal amount of notes to be converted in cash in an amount equal to the product of:

the then current conversion rate, and

the average closing price of our common stock during the cash settlement averaging period.

If we elect to satisfy a fixed portion (other than 100%) of the conversion obligation in cash, we will deliver to you such cash amount (the cash amount) and a number of shares, for each $1,000 principal amount of notes, equal to the then current conversion rate *minus* the number of shares equal to the cash amount divided by the average closing price of our common stock during the cash

settlement averaging period; provided, however, that the number of shares will not be less than zero. In addition, we will pay cash for all fractional shares of common stock as described above under General. Because, in this case, the number of shares of our common stock that we deliver on conversion will be calculated over a 10 trading day period, holders of notes bear the market risk that our common stock will decline in value between the beginning of the cash settlement averaging period and the day we deliver the shares of common stock upon conversion.

Our Right to Irrevocably Elect Payment

At any time prior to maturity, we may irrevocably elect to satisfy in cash up to 100% of the principal amount of the notes converted after the date of such election, with any remaining amount to be satisfied in shares of our common stock. Such election shall be in our sole discretion without the consent of the holders of the notes, by notice to the trustee and the holders of the notes.

In the event that we receive your notice of conversion after the election date, your notice of conversion will not be retractable, the cash settlement averaging period will be the 10 trading day period beginning on the day after receipt of your notice of conversion and settlement (in cash and/or shares) will occur on the business day following the final day of the cash settlement averaging period.

We will deliver to you, for each $1,000 principal amount of notes submitted for conversion:

a cash amount (the election amount) equal to (i) the then current conversion rate, *multiplied by* (ii) the average closing price of our common stock during the cash settlement averaging period; provided, however, that the election amount will not be more than 100% of the principal amount of a note; and

a number of shares equal to (i) the then current conversion rate, *minus* (ii) the election amount divided by the average closing price of our common stock during the cash settlement averaging period.

Conversion after the Final Notice Date

With respect to conversion notices that we receive after the final notice date, we will not send individual notices of our election to satisfy all or any portion of the conversion obligation in cash. Instead if we choose to satisfy all or any portion of the conversion obligation in cash after the final notice date, we will send, on or prior to the final notice date, a single notice to the trustee of the dollar amount to be satisfied in cash (which must be expressed either as 100% of the conversion obligation or as a fixed dollar amount).

In the event that we receive your notice of conversion after the final notice date, the following procedures will apply:

Settlement amounts will be computed and settlement dates will be determined in the same manner as set forth above under Payment Upon Conversion Conversion on or Prior to the Final Notice Date except that the cash settlement averaging period shall be the 10 trading day period beginning on the trading day after receipt of your notice of conversion. Settlement (in cash and/or shares) will occur on the third business day following the final day of such cash settlement averaging period, which date could be after the maturity date.

Conditions to Conversion

Holders may not convert their notes prior to February 17, 2005. On or after February 17, 2005, holders may surrender their notes for conversion into shares of our common stock prior to stated maturity only under the circumstances described below. Upon determination that holders of notes are or will be entitled to convert their notes, we will disseminate a press release through Dow Jones & Company, Inc. or Bloomberg Business News and publish such information on our website as soon as practicable.

Conversion Upon Satisfaction of Stock Price Condition. On or after February 17, 2005, a holder may surrender any of its notes for conversion into shares of our common stock during any fiscal quarter (and only during such fiscal quarter) if the closing price of our common stock for at least 20 trading days during the period of 30 consecutive trading days ending on the last trading day of the previous fiscal quarter is greater than or equal to 130% of the current conversion price of the notes on that 30th trading day (initially 130% of $55.94, or $72.73).

The closing price of our common stock on any date means the closing sale price per share (or, if no closing sale price is reported, the average of the bid and asked prices or, if there is more than one bid or ask price, the average of the average bid and the average asked prices) on that date as reported in composite transactions for the principal U.S. securities exchange on which our common stock is traded or, if our common stock is not listed on a U.S. national or regional securities exchange, as reported by the Nasdaq National Market. The closing price will be determined without reference to after-hours or extended market trading. If our common stock is not listed for trading on a U.S. national or regional securities exchange and not reported by the Nasdaq National Market on the relevant date, the closing price will be the last quoted bid for our common stock in the over-the-counter market on the relevant date as reported by the National Quotation Bureau or similar organization. If our common stock is not so quoted, the closing price will be the average of the midpoint of the last bid and asked prices for our common stock on the relevant date from each of at least three nationally recognized independent investment banking firms selected by us for this purpose.

Trading day means a day during which trading in securities generally occurs on the New York Stock Exchange or, if our common stock is not listed on the New York Stock Exchange, on the principal other U.S. national or regional securities exchange on which our common stock is then listed or, if our common stock is not listed on a U.S. national or regional securities exchange, on the Nasdaq National Market or, if our common stock is not reported by the Nasdaq National Market, on the principal other market on which our common stock is then traded.

Conversion Upon Redemption. If we elect to redeem notes, holders may convert the notes called for redemption into our common stock at any time prior to the close of business on the business day immediately preceding the redemption date, even if the notes are not otherwise convertible at such time.

Conversion Upon Specified Corporate Transactions. If we elect to:

- distribute to all holders of our common stock certain rights or warrants entitling them to purchase, for a period expiring within 60 days after the date of the distribution, shares of our common stock at a price per share of less than the closing price of a share of our common stock on the record date for the distribution, or

- distribute to all holders of our common stock our assets, debt securities or certain rights to purchase our securities, which distribution has a per share value, as determined by our board of directors, exceeding 10% of the closing price of a share of our common stock on the trading day immediately preceding the declaration date for such distribution, then

we must notify the holders of the notes at least 22 business days prior to the ex-dividend date for such distribution. Once we have given such notice, holders may surrender their notes for conversion at any time until the earlier of the close of business on the business day immediately prior to the ex-dividend date or our announcement that such distribution will not take place, even if the notes are not otherwise convertible at such time; provided, however, that a holder may not exercise this right to convert if the holder may participate in the distribution without conversion. The ex-dividend date is the first date upon which a sale of the common stock, carried out in the regular way on the relevant exchange or in the relevant market for our common stock, does not automatically transfer the right to receive the relevant dividend or distribution from the seller of the common stock to its buyer.

In addition, if we are party to a consolidation, merger, binding share exchange or transfer of all or substantially all of our assets pursuant to which our common stock is converted into cash, securities or other property, a holder may surrender notes for conversion at any time from and after the date which is

15 days prior to the anticipated effective date of the transaction until 15 days after the actual effective date of such transaction (or if such transaction constitutes a fundamental change, until the business day immediately preceding the applicable fundamental change purchase date). If we engage in certain reclassifications of our common stock or are a party to a consolidation, merger, binding share exchange or transfer of all or substantially all of our assets pursuant to which our common stock is converted into cash, securities or other property, then at the effective time of the transaction, the right to convert a note into our common stock will be changed into a right to convert a note into the kind and amount of cash, securities or other property that the holder would have received if the holder had converted its notes immediately prior to the applicable record date for the transaction. If we engage in any transaction described in the preceding sentence, the conversion rate will not be otherwise adjusted. If the transaction also constitutes a fundamental change, as defined below, a holder can require us to purchase all or a portion of its notes as described below under Repurchase of the Notes at the Option of the Holders Upon a Fundamental Change.

Conversion Rate Adjustments

We will adjust the conversion rate for the notes if any of the following events occur:

(1) we issue our common stock as a dividend or distribution on our common stock;

(2) we issue to all holders of common stock certain rights or warrants entitling them to purchase, for a period expiring within 60 days after the record date for the distribution, shares of our common stock at a price per share of less than the closing price of a share of our common stock on the record date for the distribution;

(3) we subdivide or combine our common stock;

(4) we distribute to all holders of our common stock capital stock, evidences of indebtedness or assets, including securities (but excluding rights or warrants listed in (2) above, dividends or distributions listed in (1) above and distributions consisting exclusively of cash), the conversion rate will be increased by multiplying the conversion rate by a fraction,

the numerator of which will be the current market price of our common stock and

the denominator of which will be the current market price of our common stock minus the fair market value, as determined by our board of directors, of the portion of those assets, debt securities, shares of capital stock or rights or warrants so distributed applicable to one share of common stock.

If we distribute capital stock of, or similar equity interests in, a subsidiary or other business unit of ours, then the conversion rate will be adjusted based on the market value of the securities so distributed relative to the market value of our common stock, in each case based on the average closing sales price of those securities (where such closing sale prices are available) for the 10 trading days commencing on and including the fifth trading day after the date on which ex-dividend trading commences for such distribution on the New York Stock Exchange or such other national or regional exchange or market on which the securities are then listed or quoted;

(5) we distribute cash, excluding any dividend or distribution in connection with our liquidation, dissolution or winding up or any quarterly cash dividend on our common stock to the extent that the aggregate cash dividend per share of common stock in any quarter does not exceed $0.16 (the dividend threshold amount); in which event the conversion rate will be increased by multiplying the conversion rate by a fraction,

the numerator of which will be the current market price of our common stock and

the denominator of which will be the current market price of our common stock minus the amount per share of such dividend (as determined below) or distribution.

The dividend threshold amount is subject to adjustment on an inversely proportional basis whenever the conversion rate is adjusted. If an adjustment is required to be made under this clause (5) as a result of a distribution that is a quarterly dividend, the adjustment would be based upon the amount by which the distribution exceeds the dividend threshold amount. If an adjustment is required to be made under this clause as a result of a distribution that is not a quarterly dividend, the adjustment would be based upon the full amount of the distribution;

(6) we or one of our subsidiaries makes a payment in respect of a tender offer or exchange offer for our common stock to the extent that the cash and value of any other consideration included in the payment per share of our common stock exceeds the closing price of our common stock on the trading day next succeeding the last date on which tenders or exchanges may be made pursuant to such tender or exchange offer, the conversion rate will be increased by multiplying the conversion rate by a fraction,

the numerator of which will be the sum of (x) the fair market value, as determined by our board of directors, of the aggregate consideration payable for all shares of our common stock we purchase in such tender or exchange offer and (y) the product of the number of shares of our common stock outstanding less any such purchased shares and the closing price of our common stock on the trading day next succeeding the expiration of the tender or exchange offer and

the denominator of which will be the product of the number of shares of our common stock outstanding, including any such purchased shares, and the closing price of our common stock on the trading day next succeeding the expiration of the tender or exchange offer; and

(7) someone other than us or one of our subsidiaries makes a payment in respect of a tender offer or exchange offer in which, as of the closing date of the offer, our board of directors is not recommending rejection of the offer, in which event the conversion rate will be increased by multiplying the conversion rate by a fraction

the numerator of which will be the sum of (x) the fair market value, as determined by our board of directors, of the aggregate consideration payable to our stockholders based on the acceptance (up to any maximum specified in the terms of the tender or exchange offer) of all shares validly tendered or exchange and not withdrawn as of the expiration of the offer and (y) the product of the number of shares of our common stock outstanding less any such purchased shares and the closing price of our common stock on the trading day next succeeding the expiration of the tender or exchange offer and

the denominator of which will be the product of the number of shares of our common stock outstanding, including any such purchased shares, and the closing price of our common stock on the trading day next succeeding the expiration of the tender or exchange offer.

The adjustment referred to in this clause (7) will be made only if:

the tender offer or exchange offer is for an amount that increases the offeror s ownership of common stock to more than 25% of the total shares of common stock outstanding; and

the cash and value of any other consideration included in the payment per share of common stock exceeds the current market price per share of common stock on the trading day next succeeding the last date on which tenders or exchanges may be made pursuant to the tender or exchange offer.

However, the adjustment referred to in this clause (7) will generally not be made if, as of the closing of the offer, the offering documents disclose a plan or an intention to cause us to engage in a consolidation or merger or a sale of all or substantially all of our assets.

In the event of clauses (5) or (6) above, in no event will the conversion rate exceed 25.0250 shares per $1,000 principal amount of notes, subject to adjustment from clauses (1) through (4) and (7).

Current market price of our common stock on any day means the average of the closing price per share of our common stock (as defined above under Conversion Rights Conditions to Conversion) for each of the 10 consecutive trading days (as defined above under Conversion Rights Conditions to Conversion) ending on the earlier of the day in question and the day before the ex-dividend date with respect to the issuance or distribution requiring such computation.

To the extent that we have a rights plan in effect upon conversion of the notes into common stock, you will receive, in addition to the common stock, the rights under the rights plan, unless prior to any conversion, the rights have separated from the common stock, in which case the conversion rate will be adjusted at the time of separation as described in clause (4) above, as if we distributed to all holders of our common stock, shares of our capital stock, evidences of indebtedness or assets as described above, subject to readjustment in the event of the expiration, termination or redemption of such rights.

In the event of:

- any reclassification of our common stock;
- a consolidation, merger, binding share exchange or combination involving us; or
- a sale or conveyance to another person or entity of all or substantially all of our property or assets;

in which holders of common stock would be entitled to receive stock, other securities, other property, assets or cash for their common stock, upon conversion of your notes you will be entitled to receive the same type of consideration that you would have been entitled to receive if you had converted the notes into our common stock immediately prior to any of these events.

The holders of the notes may, in certain circumstances, be deemed to have received a distribution subject to U.S. federal income tax as a dividend as a result of certain conversion rate adjustments. Similarly, Non-U.S. Holders of notes in certain circumstances may be deemed to have received a distribution subject to U.S. federal withholding tax requirements. See Certain United States Federal Income Tax Considerations U.S. Holders Constructive Dividends on Notes and Non-U.S. Holders Dividends and Other Potential Withholding.

To the extent permitted by law, we may, from time to time, increase the conversion rate for a period of at least 20 days if our board of directors has made a determination that this increase would be in our best interests. Any such determination by our board will be conclusive. We will give holders at least 15 days notice of any increase in the conversion rate. In addition, we may increase the conversion rate if our board of directors deems it advisable to avoid or diminish any income tax to holders of common stock or rights to purchase our common stock resulting from any dividend or distribution of stock (or rights to acquire stock) or from any event treated as such for income tax purposes.

The applicable conversion rate will not be adjusted:

- upon the issuance of any shares of our common stock pursuant to any present or future plan providing for the reinvestment of dividends or interest payable on our securities and the investment of additional optional amounts in shares of our common stock under any plan;
- upon the issuance of any shares of our common stock or options or rights to purchase those shares pursuant to any present or future employee, director or consultant benefit plan or program of or assumed by us or any of our subsidiaries;
- upon the issuance of any shares of our common stock pursuant to any option, warrant, right, or exercisable, convertible or exchangeable security not described in the immediately preceding bullets above and outstanding as of the date the notes were first issued;
- for a change in the par value of our common stock; or
- for accrued and unpaid interest.

Furthermore, we will not be required to make an adjustment in the conversion rate unless the adjustment would require a change of at least 1% in the conversion rate. However, we will carry forward any adjustments that are less than 1% of the conversion rate.

Optional Redemption by Us

Prior to February 16, 2009, the notes will not be redeemable at our option. At any time on or after February 16, 2009, we may redeem some or all of the notes for cash at 100% of their principal amount, plus accrued and unpaid interest, if any, to but excluding the purchase date.

We will give at least 30 days but not more than 60 days notice of redemption by mail to holders of notes. Notes or portions of notes called for redemption will be convertible by the holder until the close of business on the business day prior to the redemption date.

If we do not redeem all of the notes, the trustee will select the notes to be redeemed in principal amounts of $1,000 or multiples thereof, by lot or on a pro rata basis. If any notes are to be redeemed in part only, we will issue a new note or notes with a principal amount equal to the unredeemed principal portion thereof. If a portion of your notes is selected for partial redemption and you convert a portion of your notes, the converted portion will be deemed to be taken from the portion selected for redemption.

Repurchase of Notes at the Option of the Holders

Holders of notes may require us to purchase all or a portion of their notes on February 15, 2009, February 15, 2014 and February 15, 2019. In each case, the purchase price will be equal to 100% of the principal amount of the notes being purchased, plus accrued and unpaid interest, if any, to but excluding each purchase date.

We will pay the first put on February 15, 2009 in cash and subsequent puts on February 15, 2014 and February 15, 2019 in cash, stock or a combination thereof at our option. At any time prior to maturity, we may irrevocably elect in our sole discretion to satisfy 100% of the principal amount of the notes put to us after the date of such election (plus accrued and unpaid interest) in cash.

The number of shares of our common stock a holder will receive will equal the relevant amount of the purchase price divided by 100% of the average of the closing prices of our common stock for the ten trading days immediately preceding and including the third business day prior to the purchase date. Because, in this case, the number of shares of our common stock that we deliver will be calculated over a ten trading day period, holders of notes bear the market risk that our common stock will decline in value between the first day of the ten trading day period and the purchase date.

In connection with any purchase of notes, we will notify the holders of notes, not less than 22 business days prior to any purchase date, of their purchase right, the purchase date and the purchase procedures. To exercise the purchase right, prior to the close of business on the business day immediately preceding the purchase date, written notice must be received by the paying agent of your exercise of your purchase right. You may withdraw this notice if the paying agent receives a notice of withdrawal prior to the close of business on the business day immediately preceding the purchase date.

Rule 13e-4 under the Securities Exchange Act of 1934 requires the dissemination of certain information to security holders if an issuer tender offer occurs and may apply if the repurchase option becomes available to holders of the notes. We will comply with this rule, Rule 14e-1 and any other tender offer rules under the Securities Exchange Act of 1934 which may then be applicable and file Schedule TO (or any similar schedule) to the extent applicable at that time.

We shall pay the purchase price for the notes we are required to repurchase promptly following the later of the purchase date and the date that such notes are delivered to, and received by the paying agent. If the paying agent holds money or shares of common stock (or a combination thereof) sufficient to pay the purchase price of the notes which holders have elected to require us to purchase on the purchase date in accordance with the terms of the indenture, then, immediately after the purchase date, those notes will

cease to be outstanding and interest on the notes will cease to accrue, whether or not the notes are delivered to the paying agent. Thereafter, all other rights of the holders of those notes shall terminate, other than the right to receive the purchase price upon delivery of the notes.

No notes may be repurchased by us at the option of the holders if there has occurred and is continuing an event of default (other than an event of default that may be cured by payment of the purchase price). Our ability to purchase notes is subject to important limitations. Our ability to purchase the notes for cash may be limited by restrictions on our ability to obtain funds for such purchase through dividends from our subsidiaries and the terms of our then existing borrowing agreements. We cannot assure you that we would have the financial resources, or would be able to arrange financing, to pay the purchase price for all the notes that might be delivered by holders of notes seeking to exercise the purchase right.

Repurchase of Notes at the Option of the Holders Upon a Fundamental Change

If a fundamental change, as described below, occurs, you will have the right on the fundamental change repurchase date (subject to certain exceptions set forth below) to require us to repurchase, for cash, all or a portion of your notes not previously called for redemption, or any portion of those notes that is equal to $1,000 in principal amount or multiples thereof, at a fundamental change repurchase price equal to 100% of the principal amount of the notes plus any accrued and unpaid interest to but excluding the fundamental change repurchase date; provided that, if the fundamental change repurchase date is after a record date and before the next succeeding interest payment date, any accrued and unpaid interest will be paid to the holder as of that record date.

A fundamental change will be deemed to have occurred at such time after the original issuance of the notes when any of the following has occurred:

(1) the acquisition by any person, including any syndicate or group deemed to be a person under Section 13(d)(3) of the Securities Exchange Act of 1934 of beneficial ownership, directly or indirectly, through a purchase, merger or other acquisition transaction or series of purchase, merger or other acquisition transactions, of shares of our capital stock entitling that person to exercise 50% or more of the total voting power of all shares of our capital stock entitled to vote generally in elections of directors, other than any acquisition by us, any of our subsidiaries or any of our employee benefit plans (except that any of those persons shall be deemed to have beneficial ownership of all securities it has the right to acquire, whether the right is currently exercisable or is exercisable only upon the occurrence of a subsequent condition); or

(2) the first day on which a majority of the members of the board of directors of Fluor Corporation are not continuing directors; or

(3) our consolidation or merger with or into any other person, any merger of another person into us, or any conveyance, transfer, sale, lease or other disposition of all or substantially all of our properties and assets to another person, other than:

any transaction:

(a) that does not result in any reclassification, conversion, exchange or cancellation of outstanding shares of our capital stock; or

(b) pursuant to which holders of our capital stock immediately prior to the transaction have the entitlement to exercise, directly or indirectly, 50% or more of the total voting power of all shares of capital stock entitled to vote generally in elections of directors of the continuing or surviving person immediately after giving effect to such issuance; or

any merger, share exchange, transfer of assets or similar transaction solely for the purpose of changing our jurisdiction of incorporation and resulting in a reclassification, conversion or exchange of outstanding shares of common stock, if at all, solely into shares of common

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stock, ordinary shares or American Depositary Shares of the surviving entity or a direct or indirect parent of the surviving corporation, or

(4) our common stock is not listed for trading on a U.S. national securities exchange or approved for listing on the Nasdaq National Market.

However, notwithstanding the foregoing, you will not have the right to require us to repurchase your notes if:

(1) the sale price per share of our common stock for any five trading days within:

the period of 10 consecutive trading days ending immediately after the later of the fundamental change or the public announcement of the fundamental change, in the case of a fundamental change described in (1) or (2) above, or

the period of 10 consecutive trading days ending immediately before the fundamental change, in the case of a fundamental change described in (3) above,

equals or exceeds 105% of the conversion price of the notes on each of those five trading days; or

(2) 90% of the consideration in the transaction or transactions (other than cash payments for fractional shares and cash payments made in respect of dissenters appraisal rights) constituting a fundamental change consists of shares of common stock, ordinary shares or American Depositary Shares traded or to be traded immediately following a fundamental change on a U.S. national securities exchange or the Nasdaq National Market, and, as a result of the transaction or transactions, the notes become convertible into that common stock, ordinary shares or American Depositary Shares (and any rights attached thereto).

Continuing director means, as of any date of determination, any member of our board of directors who:

was a member of such board of directors on the date of the original issuance of the notes, or

was nominated for election or elected to such board of directors with the approval of a majority of the continuing directors who were members of such board at the time of such nomination or election.

On or prior to the date of repurchase, we will deposit with a paying agent an amount of money sufficient to pay the aggregate repurchase price of the notes which is to be paid on the date of repurchase.

On or before the 15th day after the fundamental change, we must mail to the trustee, the paying agent and all holders of the notes a notice of the occurrence of the fundamental change and an offer, stating the procedures which a holder must follow in order to exercise the repurchase right.

To exercise the repurchase right, holders of notes must deliver, on or before the repurchase date specified in our notice of a fundamental change, the notes to be repurchased, duly endorsed for transfer, together with a written repurchase notice, to the paying agent. The repurchase date shall be no later than 25 business days after we mail the notice of the occurrence of a fundamental change. The repurchase notice given by each holder electing to require us to repurchase notes shall include the following information:

the certificate numbers of the holder s notes to be delivered for repurchase;

the portion of the principal amount of notes to be repurchased, which must be $1,000 or a multiple of $1,000;

For a discussion of the tax treatment of a holder exercising the right to require us to purchase notes, see Certain United States Federal Income Tax Considerations U.S. Holders Sale, Exchange, Redemption or Other Disposition of Notes or Common Stock.

Any repurchase notice may be withdrawn by the holder by a written notice of withdrawal delivered to and received by the paying agent prior to the close of business on the repurchase date. The notice of withdrawal shall include the following information:

the principal amount being withdrawn; and

the certificate numbers of the notes being withdrawn.

Beneficial ownership shall be determined in accordance with Rule 13d-3 promulgated by the SEC under the Securities Exchange Act of 1934. The term person includes any syndicate or group that would be deemed to be a person under Section 13(d)(3) of the Securities Exchange Act of 1934.

Rule 13e-4 under the Securities Exchange Act of 1934 requires the dissemination of certain information to security holders if an issuer tender offer occurs and may apply if the repurchase option becomes available to holders of the notes. We will comply with this rule, Rule 14e-1 and file Schedule TO (or any similar schedule) to the extent applicable at that time.

If the paying agent holds money sufficient to pay the fundamental change repurchase price of the notes which holders have elected to require us to repurchase on the business day following the fundamental change repurchase date in accordance with the terms of the indenture, then, immediately after the fundamental change repurchase date, those notes will cease to be outstanding and interest on the notes will cease to accrue, whether or not the notes are delivered to the paying agent. Thereafter, all other rights of the holder shall terminate, other than the right to receive the fundamental change repurchase price upon delivery of the notes.

The foregoing provisions would not necessarily protect holders of the notes if highly leveraged or other transactions involving us occur that may affect holders adversely. We could, in the future, enter into certain transactions, including certain recapitalizations, that would not constitute a fundamental change with respect to the fundamental change repurchase feature of the notes but that would increase the amount of our (or our subsidiaries) outstanding indebtedness.

The definition of fundamental change includes a phrase relating to the conveyance, transfer, sale, lease or other disposition of all or substantially all of our properties and assets. There is no precise, established definition of the phrase substantially all under New York law, which is the law governing the indenture and the notes. In interpreting this phrase, courts, among other things, make a subjective determination as to the portion of assets conveyed, considering many factors, including the value of assets conveyed, the proportion of an entity s income derived from the assets conveyed and the significance of those assets to the ongoing business of the entity. To the extent the meaning of such phrase is uncertain, there may be uncertainty as to whether or not a fundamental change has occurred and, therefore, as to whether or not you will have the right to require us to repurchase your notes.

Our ability to repurchase notes for cash upon the occurrence of a fundamental change is subject to important limitations. No notes may be repurchased by us at the option of the holders upon a fundamental change if there has occurred and is continuing an event of default (other than an event of default that may be cured by payment of the repurchase price). Our ability to repurchase the notes for cash may be limited by restrictions on our ability to obtain funds for such repurchase through dividends from our subsidiaries and the terms of our then existing borrowing agreements. In addition, the occurrence of a fundamental change could cause an event of default under, or be prohibited or limited by the terms of, our other senior debt. We cannot assure you that we would have the financial resources, or would be able to arrange financing, to pay the fundamental change repurchase price in cash for all the notes that might be delivered by holders of notes seeking to exercise the repurchase right.

The fundamental change purchase feature of the notes may in certain circumstances make more difficult or discourage a takeover of our company. The fundamental change purchase feature, however, is not the result of our knowledge of any specific effort:

to accumulate shares of our common stock;

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- to obtain control of us by means of a merger, tender offer solicitation or otherwise; or
- by management to adopt a series of anti-takeover provisions.

Instead, the fundamental change repurchase feature is a standard term contained in securities similar to the notes.

Merger and Sale of Assets by Fluor

The indenture provides that we may not consolidate with or merge with or into any other person or sell, convey, transfer or lease our properties and assets substantially as an entirety to another person, unless:

- we are the continuing corporation or the successor person, if other than us, is organized and existing under the laws of the United States or any state thereof or the District of Columbia;
- the successor person assumes all of the obligations under the notes and the indenture;
- immediately after giving effect to the transaction, there is no event of default under the indenture; and
- we have delivered to the trustee an officer s certificate and an opinion of counsel each stating that the transaction complies with these requirements.

Upon any permitted consolidation, merger, conveyance, transfer or lease, the successor person will succeed to, and be substituted for, Fluor and may exercise its rights and powers under the indenture and the notes. After any such permitted transaction, we will be relieved of all obligations and covenants under the indenture and the notes.

Payment at Maturity

Each holder of $1,000 principal amount of notes shall be entitled to receive $1,000 at maturity, plus accrued and unpaid interest.

We will pay principal on:

- global notes to DTC in immediately available funds; and
- any definitive notes at our office or agency in New York City, which initially will be the corporate trust office of the trustee in New York City.

Events of Default

Each of the following constitutes an event of default under the indenture with respect to the notes:

- default in our obligation to convert any note into shares of our common stock, or cash in lieu thereof, upon exercise of a holder s conversion right and continuance of such default for 10 days;
- default in our obligation to redeem any note after we have exercised our redemption option or to purchase any note after a holder has exercised its put option;
- default in our obligation to pay the principal amount of any note when due and payable at maturity;
- default in our obligation to pay any interest on any note when due and payable, and continuance of such default for a period of 30 days;
- our failure to perform or observe any other term, covenant or agreement contained in the notes or the indenture for a period of 60 days after written notice of such failure, provided that such notice requiring us to remedy the same shall have been given to us by the trustee or to us and the trustee by the holders of at least 25% in aggregate principal amount of the notes then outstanding;

- a failure to pay when due at maturity or a default that results in the acceleration of maturity of any indebtedness for borrowed money by us or any designated subsidiary in an aggregate amount of $50 million or more, unless the acceleration is rescinded, stayed or annulled within 30 days after written notice of default is given to us by the trustee or holders of not less than 25% in aggregate principal amount of the notes then outstanding; and

- certain events of bankruptcy, insolvency or reorganization with respect to us or any of our designated subsidiaries or any group of two or more subsidiaries that, taken as a whole, would constitute a designated subsidiary.

A designated subsidiary shall mean any existing or future, direct or indirect, subsidiary of ours whose assets constitute 15% or more of our total assets on a consolidated basis.

Our obligations under the indenture are not intended to provide creditor rights for amounts in excess of par plus accrued and unpaid interest.

The indenture will provide that the trustee shall, within 90 days of the occurrence of a default, give to the registered holders of the notes notice of all uncured defaults known to it and written notice of any event which, with giving of notice or the lapse of time, or both, would become an event of default, but the trustee shall be protected in withholding such notice if it, in good faith, determines that the withholding of such notice is in the best interest of such registered holders, except the trustee will not be so protected if it withholds a notice of default in the case of a default under any of the first four bullets above.

If certain events of default specified in the last bullet point above shall occur and be continuing, then automatically the principal amount of the notes then outstanding plus any accrued and unpaid interest through such date shall become immediately due and payable. If any other event of default shall occur and be continuing (the default not having been cured or waived as provided under Modification and Waiver below), the trustee or the holders of at least 25% in aggregate principal amount of the notes affected thereby may declare such notes due and payable at their principal amount plus any accrued and unpaid interest and thereupon the trustee may, at its discretion, proceed to protect and enforce the rights of the holders of such notes by appropriate judicial proceedings. Such declaration may be rescinded or annulled with the written consent of the holders of a majority in aggregate principal amount of the notes affected thereby upon the conditions provided in the indenture.

The indenture contains a provision entitling the trustee, under certain conditions, to be indemnified by the holders of notes before proceeding to exercise any right or power under the indenture at the request of such holders. The indenture provides that the holders of a majority in aggregate principal amount of the notes, through their written consent, may direct the time, method and place of conducting any proceeding for any remedy available to the trustee or exercising any trust or power conferred upon the trustee, subject to limitations specified in the indenture.

We will be required to furnish annually to the trustee a statement as to the fulfillment of our obligations under the indenture.

Modification and Waiver

Changes Requiring Approval of Each Affected Holder

The indenture (including the terms and conditions of the notes) cannot be modified or amended without the written consent or the affirmative vote of the holder of each note affected by such change to:

- change the maturity of any note or the payment date of any installment of interest payable on any notes;

- reduce the principal amount of, any interest on, or any redemption price, fundamental change purchase price or purchase price of, any note;

- change the currency of payment of such notes or interest thereon;

- alter the manner of calculation or rate of interest on any note or extend the time for payment of any such amount;
- impair the right to institute suit for the enforcement of any payment on or with respect to, or conversion of, any note;
- modify our obligation to maintain an office or agency in New York City;
- except as otherwise permitted or contemplated by the indenture, adversely affect the repurchase option of holders or the conversion rights of holders of the notes;
- modify the redemption provisions of the indenture in a manner adverse to the holders of notes;
- reduce the percentage in aggregate principal amount of notes outstanding necessary to modify or amend the indenture or to waive any past default; or
- reduce the percentage in aggregate principal amount of notes outstanding required for any other waiver under the indenture.

Changes Requiring Majority Approval

The indenture (including the terms and conditions of the notes) may be modified or amended, subject to the provisions described above, with the written consent of the holders of at least a majority in aggregate principal amount of the notes affected thereby.

Changes Not Requiring Any Approval

The indenture (including the terms and conditions of the notes) may be modified or amended by us and the trustee, without the consent of the holder of any note, for the purposes of, among other things:

- adding to our covenants for the benefit of the holders of notes;
- surrendering any right or power conferred upon us;
- providing for conversion rights of holders of notes if any reclassification or change of our common stock or any consolidation, merger or sale of all or substantially all of our assets occurs;
- providing for the assumption of our obligations to the holders of notes in the case of a merger, consolidation, conveyance, transfer or lease and the release of the predecessor;
- increasing the conversion rate, provided that the increase will not adversely affect the interests of the holders of notes;
- complying with the requirements of the SEC in order to effect or maintain the qualification of the indenture under the Trust Indenture Act of 1939;
- curing any ambiguity or correcting or supplementing any defective provision contained in the indenture; provided that such modification or amendment does not, in the good faith opinion of our board of directors and the trustee, adversely affect the interests of the holders of notes in any material respect; or
- making, adding or modifying any other provisions with respect to matters or questions arising under the indenture that we may deem necessary or desirable and which does not, in the good faith opinion of our board of directors and the trustee, adversely affect the interests of the holders of notes in any material respect.

Waiver

The holders of not less than a majority in aggregate principal amount of the outstanding notes that would be affected by a default (voting as one class) may, on behalf of the holders of all the notes, waive any past default under the indenture with respect to such notes and its consequences, except a default:

(1) in the payment of the principal of or interest on any notes, or

(2) in respect of a covenant or provision of the indenture which cannot be modified or amended without the consent of the holder of each note affected by such a default.

Form, Denomination and Registration

Denomination and Registration

The notes will be issued in fully registered form, without coupons, in denominations of $1,000 principal amount and multiples thereof.

Global Notes

Notes will be evidenced by one or more global notes deposited with the trustee as custodian for DTC, and registered in the name of Cede & Co. as DTC s nominee.

Record ownership of the global notes may be transferred, in whole or in part, only to another nominee of DTC or to a successor of DTC or its nominee, except as set forth below. An owner of beneficial interests may hold its interests in the global notes directly through DTC if such owner is a participant in DTC, or indirectly through organizations which are direct DTC participants if such owner is not a participant in DTC. Transfers between direct DTC participants will be effected in the ordinary way in accordance with DTC s rules and will be settled in same-day funds. You may also beneficially own interests in the global notes held by DTC through certain banks, brokers, dealers, trust companies and other parties that clear through or maintain a custodial relationship with a direct DTC participant, either directly or indirectly.

So long as Cede & Co., as nominee of DTC, is the registered owner of the global notes, Cede & Co. for all purposes will be considered the sole holder of the global notes. Except as provided below, owners of beneficial interests in the global notes:

- will not be entitled to have certificates registered in their names; and

- will not be considered holders of the global notes.

The laws of some states require that certain persons take physical delivery of securities in definitive form. Consequently, the ability of an owner of a beneficial interest in a global security to transfer the beneficial interest in the global security to such persons may be limited.

We will wire, through the facilities of the trustee, payments of principal, interest, the redemption price, fundamental change purchase price or purchase price on the global notes to Cede & Co., the nominee of DTC, as the registered owner of the global notes. None of us, the trustee or any paying agent will have any responsibility or be liable for paying amounts due on the global notes to owners of beneficial interests in the global notes.

It is DTC s current practice, upon receipt of any payment on the global notes, to credit participants accounts on the payment date in amounts proportionate to their respective beneficial interests in the notes represented by the global notes, as shown on the records of DTC. Payments by DTC participants to owners of beneficial interests in notes represented by the global notes held through DTC participants will be the responsibility of DTC participants, as is now the case with securities held for the accounts of customers registered in street name.

If you would like to convert your notes into common stock pursuant to the terms of the notes, you should contact your broker or other direct or indirect DTC participant to obtain information on procedures, including proper forms and cut-off times, for submitting those requests.

Because DTC can only act on behalf of DTC participants, who in turn act on behalf of indirect DTC participants and other banks, your ability to pledge your interest in the notes represented by global notes to persons or entities that do not participate in the DTC system, or otherwise take actions in respect of such interest, may be affected by the lack of a physical certificate.

We will issue the notes in definitive certificated form if DTC notifies us that it is unwilling or unable to continue as depositary or DTC ceases to be a clearing agency registered under the Securities Exchange Act of 1934 and a successor depositary is not appointed by us within 90 days. In addition, beneficial interests in a global note may be exchanged for definitive certificated notes upon request by or on behalf of DTC in accordance with DTC s customary procedures. We may determine at any time and in our sole discretion that notes shall no longer be represented by global notes, in which case we will issue certificates in definitive form in exchange for the global notes.

Neither we nor the trustee (nor any registrar, paying agent or conversion agent under the indenture) will have any responsibility for the performance by DTC or direct or indirect DTC participants of their obligations under the rules and procedures governing their operations. DTC has advised us that it will take any action permitted to be taken by a holder of notes, including, without limitation, the presentation of notes for conversion or repurchase as described below, only at the direction of one or more direct DTC participants to whose account with DTC interests in the global notes are credited and only for the principal amount of the notes for which directions have been given.

DTC has advised us as follows: DTC is a limited-purpose trust company organized under the New York Banking Law, a banking organization within the meaning of the New York Banking Law, a member of the Federal Reserve System, a clearing corporation within the meaning of the New York Uniform Commercial Code and a clearing agency registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC was created to hold securities for DTC participants and to facilitate the settlement of securities transactions among DTC participants through electronic computerized book-entry changes to the accounts of its participants, thereby eliminating the need for physical movement of securities certificates. Participants include securities brokers and dealers, banks, trust companies and clearing corporations and may include certain other organizations, such as the underwriter of the notes. Certain DTC participants or their representatives, together with other entities, own DTC. Indirect access to the DTC system is available to others such as banks, brokers, dealers and trust companies that clear through, or maintain a custodial relationship with, a participant, either directly or indirectly.

Although DTC has agreed to the foregoing procedures in order to facilitate transfers of interests in the global notes among DTC participants, it is under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. None of us, the trustee or any of either s respective agents will have any responsibility for the performance by DTC or direct or indirect DTC participants of their obligations under the rules and procedures governing their operations, including maintaining, supervising or reviewing the records relating to or payments made on account of beneficial ownership interests in global notes.

The information in this section concerning DTC and DTC s book-entry system has been obtained from sources that we believe to be reliable, but we take no responsibility for the accuracy thereof.

Governing Law

The indenture and the notes will be governed by, and construed in accordance with, the laws of the State of New York.

Limited Liability of Certain Persons

The indenture provides that none of our past, present or future incorporators, stockholders, directors, officers or employees, or of any successor corporation or any of our affiliates, shall have any personal liability in respect of our obligations under the indenture or the notes by reason of his, her or its status as an incorporator, stockholder, director, officer or employee. Each holder of the notes, by accepting a note,

waives and releases all such liability. Such waiver may not be effective to waive liabilities under the federal securities laws and it is the view of the SEC that such a waiver is against public policy.

Information Concerning the Trustee

The Bank of New York, as trustee under the indenture, has been appointed by us as paying agent, conversion agent, calculation agent and registrar with regard to, and will serve as DTC s custodian for, the notes. The trustee or its affiliates may from time to time in the future provide banking and other services to us in exchange for a fee.

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DESCRIPTION OF CAPITAL STOCK

The following description of our capital stock and provisions of our amended and restated certificate of incorporation and bylaws is only a summary. You should refer to the copies of our amended and restated certificate of incorporation and bylaws which have been filed with the SEC.

Our authorized capital stock consists of 150,000,000 shares of common stock and 20,000,000 shares of preferred stock. As of February 6, 2004, 82,175,922 shares of our common stock were issued and outstanding and held of record by approximately 6,456 holders; no shares of our preferred stock were issued or outstanding.

Common Stock

Voting Rights

Holders of our common stock are entitled to one vote per share on all matters voted on generally by stockholders. Except as otherwise required by law or with respect to any outstanding series of our preferred stock, the holders of our common stock possess all voting power. Our bylaws generally provide that stockholder action is effective upon majority vote. However, an affirmative vote of the holders of at least 80% of the voting power of outstanding shares is required to:

- amend or repeal the bylaws;
- merge or consolidate with another corporation or entity, which together with its affiliates, beneficially owns more than 15% of the outstanding shares of Fluor, such other corporation and its affiliates referred to as a related corporation;
- sell or exchange substantially all of its assets or business to or with a related corporation; or
- issue or deliver any stock or securities in exchange or payment for any assets or property of or securities issued by a related corporation;

unless such actions are approved by our board of directors.

Furthermore, the affirmative vote of the holders of 80% of the voting power of outstanding shares must approve changes to provisions in our amended and restated certificate of incorporation relating to:

- the amendment of our bylaws;
- the classification of our board of directors;
- the prohibition of stockholder action without a meeting; and
- the requirement that 80% of the voting power of the outstanding shares must approve certain changes.

Dividend Rights; Rights Upon Liquidation

Subject to any preferential rights of holders of any our preferred stock that may be outstanding, holders of shares of our common stock are entitled to receive dividends on such stock out of assets legally available for distribution when, as and if authorized and declared by our board of directors and to share ratably in the assets of Fluor legally available for distribution to its stockholders in the event of its liquidation, dissolution or winding-up.

Classification of Our Board of Directors

Our board of directors is divided into three classes of directors serving staggered three-year terms. As a result, approximately one-third of our directors are elected each year. This limits the ability of majority stockholders or persons holding proxies to vote a majority of our shares to change control of our board of directors in fewer than two annual stockholder meetings. This limitation could have the effect of

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discouraging a potential acquiror from making a tender offer or otherwise attempting to obtain control of Fluor and could thus increase the likelihood that incumbent directors will retain their positions.

Miscellaneous

Holders of our common stock will have no preferences or preemptive, conversion or exchange rights. Shares of our common stock will not be liable for further calls or assessments by Fluor, and the holders of our common stock will not be liable for any liabilities of Fluor.

Preferred Stock

Our amended and restated certificate of incorporation authorizes our board of directors to issue from time to time, without further vote or action by the stockholders, up to 20,000,000 shares of our preferred stock in one or more series and to fix the designations, powers, preferences and rights, and any qualifications, limitations or restrictions, with respect to the shares issued under each such series. Because our board of directors have the power to establish the designations, powers, preferences and rights of the shares of any such series of our preferred stock, holders of our preferred stock may be afforded voting rights and preferences, powers and other rights that could adversely affect the rights of holders of our common stock. This could have the effect of discouraging a potential acquiror from making a tender offer or otherwise attempt to obtain control of Fluor through the acquisition of our common stock.

Anti-Takeover Provisions

General

The provisions of our amended and restated certificate of incorporation, our bylaws and Section 203 of the Delaware General Corporation Law may have the effect of impeding the acquisition of control of Fluor by means of a tender offer, a proxy fight, open market purchases or otherwise in a transaction not approved by our board of directors. These provisions are designed to reduce, or have the effect of reducing, the vulnerability of Fluor to an unsolicited proposal for the restructuring or sale of all or substantially all the assets of Fluor or an unsolicited takeover attempt which is unfair to Fluor stockholders.

Charter and Bylaw Provisions

Our amended and restated certificate of incorporation authorizes our board of directors to issue from time to time, without further vote or action by the stockholders, up to 20,000,000 shares of our preferred stock in one or more series and to fix the designations, powers, preferences and rights, and any qualifications, limitations or restrictions, with respect to the shares issued under each such series. Pursuant to this authority, our board could create and issue a series of our preferred stock with such designations, powers, preferences and rights which have the effect of discriminating against an existing or prospective holder of our capital stock, thus making it more difficult for, or discouraging any attempt by, a potential acquiror to obtain control of Fluor by means of a merger, tender offer, proxy contest or otherwise. As a result, the authority to issue shares of preferred stock may have the effect of delaying, deferring or preventing a change in control of Fluor without any further action by our stockholders.

Other provisions of our amended and restated certificate of incorporation and bylaws that may make it more difficult to replace our board of directors include:

- the 80% supermajority voting requirements to approve certain extraordinary corporate transactions or certain amendments to our amended and restated certificate of incorporation or bylaws, as described under Common Stock Voting Rights ;
- classification of our board of directors as described under Common Stock Classification of Our Board of Directors ;
- prohibition on stockholders calling a meeting or acting by written consent;

- requirements for advance notice for raising business or making nominations at stockholder meetings; and

- the ability of the our board of directors to increase the size of our board and to fill vacancies on our board.

Section 203 of the Delaware General Corporation Law

We are subject to Section 203 of the Delaware General Corporation Law. The provisions of Section 203 prohibit a publicly-held Delaware corporation from engaging in certain business combinations with an interested stockholder for a period of three years after the date that the person became an interested stockholder, unless one of the following conditions is satisfied:

- prior to the date that the person became an interested stockholder, the transaction or business combination that resulted in the person becoming an interested stockholder is approved by the board of directors;

- upon consummation of the transaction that resulted in the stockholder becoming an interested stockholder, the interested stockholder owns at least 85% of our outstanding voting stock; or

- on or after the date that the person became an interested stockholder, the business combination is approved by our board of directors and by the holders of at least two-thirds of our outstanding voting stock, excluding voting stock owned by the interested stockholder.

Generally, a business combination includes a merger, asset or stock sale or other transaction resulting in a financial benefit to the interested stockholder. Subject to certain exceptions, an interested stockholder is a person who together with that person s affiliates and associates owns, or within the previous three years did own, 15% or more of our voting stock.

Transfer Agent and Registrar

The transfer agent and registrar for our common stock is ChaseMellon Shareholder Services, L.L.C.

CERTAIN UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS

This section summarizes certain U.S. federal income tax considerations relating to the purchase, ownership, and disposition of the notes and of common stock into which the notes may be converted. This summary does not provide a complete analysis of all potential tax considerations. The information provided below is based on existing authorities. These authorities may change, or the IRS might interpret the existing authorities differently. In either case, the tax considerations of purchasing, owning or disposing of notes or common stock could differ from those described below. This summary deals only with purchasers who purchase notes at their issue price, which will equal the first price to the public (not including bond houses, brokers or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers) at which a substantial amount of the notes is sold for money, and who hold notes or common stock into which notes have been converted as capital assets within the meaning of Section 1221 of the Internal Revenue Code of 1986. This summary does not deal with persons in special tax situations, such as financial institutions, insurance companies, S corporations, regulated investment companies, tax exempt investors, dealers in securities and currencies, U.S. expatriates, persons holding notes as a position in a straddle, hedge, conversion transaction, or other integrated transaction for tax purposes, or U.S. Holders (as defined below) whose functional currency is not the U.S. dollar. Further, this discussion does not address the consequences under U.S. alternative minimum tax rules, U.S. federal estate or gift tax laws (except as specifically described below with respect to Non-U.S. Holders), the laws of any U.S. state or locality, or any non-U.S. tax laws.

You should consult your own tax advisor regarding the application of the U.S. federal income tax laws to your particular situation and the consequences of federal estate or gift tax laws, foreign, state, or local laws, and tax treaties.

As used herein, the term U.S. Holder means a beneficial owner of notes or common stock into which notes have been converted that is, for U.S. federal income tax purposes:

- an individual citizen or resident of the United States;
- a corporation, or other entity that has elected to be treated as a corporation, created or organized in or under the laws of the United States, any state thereof or the District of Columbia;
- an estate, the income of which is subject to U.S. federal income tax regardless of its source; or
- a trust if, (1) a court within the United States is able to exercise primary supervision over its administration and one or more U.S. persons have authority to control all of its substantial decisions or (2) it has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

As used herein, the term Non-U.S. Holder means a beneficial owner, other than a partnership, of notes or common stock into which notes have been converted that is not a U.S. Holder.

If a partnership, including for this purpose any entity treated as a partnership for U.S. tax purposes, or other flow-through entity, is a beneficial owner of notes or common stock into which notes have been converted, the treatment of a partner in the partnership or an owner of the flow-through entity will generally depend upon the status of the partner or owner and upon the activities of the partnership or other flow-through entity. A holder of notes that is a partnership or other flow-through entity, and partners in such a partnership or owners of such other flow-through entity, should consult their tax advisors about the U.S. federal income tax consequences of holding and disposing of notes and common stock into which notes have been converted.

U.S. Holders

Taxation of Interest

A U.S. Holder will be required to recognize as ordinary income any interest paid or accrued on the notes, in accordance with such holder s regular method of accounting for federal income tax purposes. In

general, if the terms of a debt instrument entitle a holder to receive payments other than fixed periodic interest that exceeds the issue price of the instrument, the holder may be required to recognize additional amounts as original issue discount over the term of the instrument. We expect that the notes will not be issued with original issue discount.

Sale, Exchange, Redemption or Other Disposition of Notes

A U.S. Holder will generally recognize capital gain or loss if the holder disposes of a note in a sale, exchange, redemption or other disposition other than a conversion of the note into common stock or a repurchase of the note for common stock, both of which are discussed below in Conversion or Repurchase of Notes for Common Stock. The holder s gain or loss will equal the difference between the proceeds received by the holder and the holder s adjusted tax basis in the note. The proceeds received by the holder will include the amount of any cash and the fair market value of any other property received for the note. The holder s tax basis in the note will generally equal the amount the holder paid for the note. The portion of any proceeds that is attributable to accrued interest will not be taken into account in computing the holder s capital gain or loss. Instead, that portion will be recognized as ordinary interest income to the extent that the holder has not previously included the accrued interest in income. The gain or loss recognized by a holder on a disposition of the note will be long-term capital gain or loss if the holder held the note for more than one year. Long-term capital gains of non-corporate taxpayers are generally taxed at lower rates than those applicable to ordinary income. The deductibility of capital losses is subject to limitation.

Constructive Dividends on Notes

The terms of the notes allow for changes in the conversion rate of the notes in certain circumstances. A change in conversion rate that allows noteholders to receive more shares of common stock on conversion may increase the noteholders proportionate interests in our earnings and profits or assets. In that case, the noteholders would be treated as though they received a dividend in the form of our stock. Such a constructive stock dividend could be taxable to the noteholders, although they would not actually receive any cash or other property. A taxable constructive stock dividend would result, for example, if the conversion rate is adjusted to compensate noteholders for distributions of cash (such as a cash dividend in excess of $0.16 per share per quarter) or property to our stockholders. Not all changes in conversion rate that allow noteholders to receive more stock on conversion, however, increase the noteholders proportionate interests in the company. For instance, a change in conversion rate could simply prevent the dilution of the noteholders interests upon a stock split or other change in capital structure. Changes of this type, if made by a bona fide, reasonable adjustment formula, are not treated as constructive stock dividends. Conversely, if an event occurs that dilutes the noteholders interests and the conversion rate is not adjusted, the resulting increase in the proportionate interests of our stockholders could be treated as a taxable stock dividend to them. Any taxable constructive stock dividends resulting from a change to, or failure to change, the conversion rate would be treated like dividends paid in cash or other property. Such taxable constructive stock dividends would result in a taxable dividend to the recipient to the extent of our current or accumulated earnings and profits, with any excess treated as a tax-free return of capital or as capital gain. Under recently enacted legislation, dividends received by noncorporate holders may be subject to U.S. federal income tax at lower rates than other types of ordinary income if certain conditions are met. Holders should consult their own tax advisors regarding the implications of this new legislation in their particular circumstances.

Conversion or Repurchase of Notes

Upon a conversion or repurchase of a note where we deliver solely our common stock (other than cash in lieu of a fractional share), a U.S. Holder generally will not recognize any income, gain or loss, except that the fair market value of common stock received with respect to accrued interest will be taxed as a payment of interest (as described above). If the holder receives cash in lieu of a fractional share of stock, however, the holder would be treated as if he received the fractional share and then had the

fractional share redeemed for the cash. The holder would recognize gain or loss equal to the difference between the cash received and that portion of his basis in the stock attributable to the fractional share. The holder s adjusted tax basis in the common stock received will equal his adjusted tax basis in the note, reduced by any basis allocable to a fractional share and increased by the amount of any income recognized with respect to accrued interest.

Upon a conversion or repurchase of a note where we deliver a combination of our common stock and cash (and such cash is not merely received in lieu of a fractional share of common stock), the tax treatment of the holder is uncertain. The fair market value of common stock and cash received with respect to accrued interest will be taxed as a payment of interest (as described above). The holder would generally not recognize loss, but would generally recognize capital gain, if any, on the note converted in an amount equal to the lesser of the gain realized and the cash received (except for cash received with respect to accrued interest, and possibly with respect to cash received in lieu of a fractional share, which may be treated in the manner discussed in the previous paragraph). Such gain would generally be long-term capital gain if the holder held the note for more than one year. The holder s adjusted tax basis in the common stock received should generally equal the adjusted tax basis of the note converted, decreased by the cash received, and increased by the amount of gain recognized and the amount of income recognized with respect to accrued interest. Alternatively, the cash payment may be treated as proceeds from the sale of a portion of the note, and taxed in the manner described under U.S. Holders Sale, Exchange, Redemption or Other Disposition of Notes, above. In such case, the holder s basis in the note would be allocated pro rata between the common stock received and the portion of the note that is treated as sold for cash. U.S. Holders should consult their own tax advisors regarding the proper treatment to them of the receipt of a combination of cash and common stock upon a conversion.

Upon a conversion or repurchase of a note where we deliver solely cash, such cash payment will be treated as a sale of the note by the U.S. Holder as described above under U.S. Holders Sale, Exchange, Redemption or Other Disposition of Notes, except that cash received with respect to accrued interest will be taxed as a payment of interest (as described above).

The holder s holding period for any common stock received on conversion will include the period during which he held the note, except that the holding period of any common stock received with respect to accrued interest will commence on the day after the date of conversion.

Dividends on Common Stock

If, after a U.S. Holder converts a note into common stock, we make a distribution in respect of that stock, other than certain pro rata distributions of shares of common stock, the distribution will be treated as a taxable dividend, to the extent it is paid from our current or accumulated earnings and profits. If the distribution exceeds our current and accumulated profits, the excess will be treated first as a tax-free return of the holder s investment, up to the holder s basis in its common stock. Any remaining excess will be treated as capital gain. If the U.S. Holder is a U.S. corporation, it would generally be able to claim a deduction equal to a portion of any dividends received. Under recently enacted legislation, dividends received by noncorporate holders may be subject to U.S. federal income tax at lower rates than other types of ordinary income if certain conditions are met. Holders should consult their own tax advisors regarding the implications of this new legislation in their particular circumstances.

Sale of Common Stock

A U.S. Holder will generally recognize capital gain or loss on a sale or exchange of common stock. The holder s gain or loss will equal the difference between the proceeds received by the holder and the holder s adjusted tax basis in the stock. The proceeds received by the holder will include the amount of any cash and the fair market value of any other property received for the stock. The gain or loss recognized by a holder on a sale or exchange of stock will be long-term capital gain or loss if the holder held the stock for more than one year.

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Non-U.S. Holders

This section applies to Non-U.S. Holders for which interest and gain received are not effectively connected with their conduct of a U.S. trade or business. If the interest and gain received are effectively connected with the conduct of a U.S. trade or business by a Non-U.S. Holder, the Non-U.S. Holder will be subject to rules similar to those described above for U.S. Holders. However, these rules are complex and Non-U.S. Holders should consult their own tax advisors concerning the applicability of the U.S. federal tax laws and the laws of any relevant state, local or non-U.S. taxing jurisdiction.

Taxation of Interest

Payments of interest to nonresident persons or entities are generally subject to U.S. federal income tax at a rate of 30%, collected by means of withholding by the payor. Payments of interest on the notes to most Non-U.S. Holders, however, will qualify as portfolio interest, and thus will be exempt from the withholding tax, if the holders certify their nonresident status as described below. The portfolio interest exception will not apply to payments of interest to a Non-U.S. Holder that:

- owns, directly or indirectly, at least 10% of our voting stock; or

- is a controlled foreign corporation that is, directly or indirectly, related to us.

In general, a foreign corporation is a controlled foreign corporation if more than 50% of its stock is owned, directly or indirectly, by one or more U.S. persons that each owns, directly, indirectly or constructively, at least 10% of the corporation s voting stock.

Even if the portfolio interest exception does not apply, payments of interest to a nonresident person or entity might not be subject to withholding tax, or might be subject to withholding tax at a reduced rate, under the terms of an applicable income tax treaty between the United States and the Non-U.S. Holder s country of residence.

The portfolio interest exception, entitlement to treaty benefits and several of the special rules for Non-U.S. Holders described below apply only if the holder certifies its nonresident status. A Non-U.S. Holder can meet this certification requirement by providing a Form W-8BEN or appropriate substitute form to us or our paying agent. If the holder holds the note through a financial institution or other agent acting on the holder s behalf, the holder will be required to provide appropriate documentation to the agent. The holder s agent will then be required to provide certification to us or our paying agent, either directly or through other intermediaries. For payments made to a foreign partnership or other flow-through entity, the certification requirements generally apply to the partners or other owners rather than to the partnership or other entity, and the partnership or other entity must provide the partners or other owners documentation to us or our paying agent. In addition, the agent, partnership or other flow-through entity may have to comply with some certification requirements as intermediaries.

Sale, Exchange, Redemption or Other Disposition of Notes or Common Stock

A Non-U.S. Holder generally will not be subject to U.S. federal income tax on any gain realized on the sale, exchange, redemption or other disposition of notes or common stock, including a conversion of notes into cash. This general rule, however, is subject to several exceptions. For example, the gain would be subject to U.S. federal income tax if:

- the Non-U.S. Holder was a citizen or resident of the United States and thus is subject to special rules that apply to expatriates; or

- the Non-U.S. Holder was an individual and was present in the United States for at least 183 days during the year in which he disposes of the notes and other conditions are satisfied.

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Conversion of Notes Into Common Stock

A Non-U.S. Holder generally will not recognize any income, gain or loss on converting a note solely into common stock. See Non-U.S. Holders Sale, Exchange, Redemption or Other Disposition of Notes or Common Stock above regarding the taxation of cash received, including cash received in lieu of a fractional share of common stock, upon the conversion of a note.

Dividends and Other Potential Withholding

Dividends, other than certain pro rata distributions of shares of common stock, paid to a Non-U.S. Holder on common stock received on conversion of a note (and any deemed dividends resulting from certain adjustments, or failure to make adjustments, to the number of shares of common stock to be issued on conversion, see U.S. Holders Constructive Dividends on Notes above) will generally be subject to U.S. withholding tax at a 30% rate. The withholding tax might not apply, however, or might apply at a reduced rate, under the terms of an applicable income tax treaty between the United States and the Non-U.S. Holder s country of residence. A Non-U.S. Holder must demonstrate its entitlement to treaty benefits by certifying its nonresident status. Some of the common means of meeting this requirement are described above under Non-U.S. Holders Taxation of Interest.

U.S. Federal Estate Tax

The estates of nonresident alien individuals are subject to U.S. federal estate tax on property with a U.S. situs. The notes will not be U.S. situs property as long as (1) the holder did not actually (or constructively) own 10% or more of the total combined voting power of all classes of our voting stocks within the meaning of the Code and applicable U.S. Treasury regulations and (2) interest on those notes would not have been, if received at the time of the holder s death, effectively connected with the conduct of a trade or business in the United States by the holder.

Because we are a U.S. corporation, our common stock will be U.S. situs property and therefore will be included in the taxable estate of a nonresident alien decedent. The U.S. federal estate tax liability of the estate of a nonresident alien may be affected by a tax treaty between the United States and the decedent s country of residence.

Backup Withholding and Information Reporting

Payments of interest or dividends to both individual U.S. Holders and Non-U.S. Holders of notes or common stock and payments of the proceeds of the sale or other disposition of the notes or common stock to individual U.S. Holders will be subject to information reporting. In addition, payments of the proceeds of the sale or other disposition of the notes or common stock to individual Non-U.S. Holders may be subject to information reporting unless the Non-U.S. Holder complies with certain certification procedures. Payments to both individual U.S. Holders and Non-U.S. Holders may also be subject to backup withholding unless the holder provides us or our paying agent with a correct taxpayer identification number and complies with applicable certification requirements.

Backup withholding is not an additional tax. Any amounts withheld from a payment to a holder of notes or common stock under the backup withholding rules can be credited against any U.S. federal income tax liability of the holder.

The preceding discussion of certain U.S. federal income tax considerations is for general information only; it is not tax advice. You should consult your own tax advisor regarding the particular U.S. federal, state, local and foreign tax consequences of purchasing, holding and disposing of our notes or common stock, including the consequences of any proposed change in applicable laws.

UNDERWRITING

Banc of America Securities LLC and Citigroup Global Markets Inc. are joint bookrunners and are acting as representatives of the underwriters listed below. The underwriters listed below have severally agreed, subject to the terms and conditions of the underwriting agreement dated the date of this prospectus supplement, to purchase from us, and we have agreed to sell them, the principal amount of notes as set forth in the following table:

Underwriters	Principal Amount
Banc of America Securities LLC	$131,250,000
Citigroup Global Markets Inc.	131,250,000
Lehman Brothers Inc.	22,500,000
BNP Paribas Securities Corp.	15,000,000
Total	$300,000,000

The underwriting agreement provides that the obligation of the several underwriters to purchase the notes is subject to specified conditions, including the delivery of specified legal opinions by its counsel as well as other conditions. Subject to the terms and conditions of the underwriting agreement, the underwriters are obligated to purchase all of the notes, if they purchase any of the notes, and have agreed to resell such notes to purchasers as described in this section.

The underwriters propose to offer some of the notes directly to the public at the public offering price set forth on the cover page of this prospectus supplement and some of the notes to dealers at the public offering price less a concession not to exceed 1.2% of the principal amount of the notes. After the initial offering of the notes to the public, the representatives may change the public offering price and concessions.

We have granted to the underwriters an option exercisable within 30 days from the date of this prospectus supplement to purchase up to an additional $30,000,000 principal amount at maturity of the notes at the public offering price less the underwriters discounts solely to cover over-allotments.

We and certain of our officers and directors have agreed, except as contemplated by this offering and subject to certain exceptions, not to offer, sell or otherwise dispose of any shares of our common stock or any securities convertible or exchangeable into our common stock for a period of 60 days from the date of this prospectus supplement without the prior written consent of Banc of America Securities LLC and Citigroup Global Markets Inc. Certain of our executive officers and directors have agreed pursuant to lock-up agreements that, without the prior written consent of Banc of America Securities LLC and Citigroup Global Markets Inc., they will not, except in certain limited circumstances and except for up to 30,000 shares of our common stock per person, directly or indirectly, offer, sell or otherwise dispose of any shares of our common stock or any securities convertible or exchangeable into our common stock for a period of 60 days from the date of this prospectus supplement. The foregoing restriction on sales does not apply to our ability to sell securities to the underwriters pursuant to the underwriting agreement or to the issuance by us of shares of our common stock issued on conversion of the notes and existing reservations, agreements and stock option and employee benefit plans.

The notes are new securities for which there is no market. The underwriters have advised us that they intend to make a market in the notes. The underwriters are not obligated, however, to make a market in the notes and any such market making may be discontinued at any time at the sole discretion of either underwriter. Accordingly, we cannot assure the liquidity of, or trading market for the notes.

We do not intend to apply for listing of the notes on any securities exchange or for inclusion of the notes in any automated quotation system.

Each underwriter has represented, warranted and agreed that: (i) it has not offered or sold and, prior to the expiry of a period of six months from the closing date, will not offer or sell any notes to persons in the United Kingdom except to persons whose ordinary activities involve them in acquiring, holding,

managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995; (ii) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act of 2000, or FSMA) received by it in connection with the issue or sale of any notes in circumstances in which section 21(1) of the FSMA does not apply to Fluor, and (iii) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the notes in, from or otherwise involving the United Kingdom.

In order to facilitate the offering of the notes, Citigroup Global Markets Inc. on behalf of the underwriters may engage in transactions that stabilize, maintain or otherwise affect the price of the notes and the common stock. These transactions may include short sales, stabilizing transactions and purchases to cover positions created by short sales. Short sales involve the sale by the underwriters of a greater number of the notes than it is required to purchase in the offering. Covered short sales are sales made in an amount not greater than the underwriters option to purchase additional notes from us in the offering. The underwriters may close out any covered short position by either exercising the option to purchase additional notes or purchasing notes in the open market. In determining the source of notes to close out the covered short position, the underwriters will consider, among other things, the price of notes available for purchase in the open market as compared to the price at which it may purchase notes through the option. Naked short sales are sales in excess of the option. The underwriters must close out any naked short position by purchasing notes in the open market. A naked short position is more likely to be created if the underwriters are concerned that there may be a downward pressure on the price of the notes in the open market after pricing that could adversely affect investors who purchase in the offering. Stabilizing transactions consist of certain bids for or purchases of the notes made by the underwriters in the open market prior to the completion of the offering. Any of these activities may stabilize or maintain the market price of the notes above independent market levels. The underwriters are not required to engage in these activities, and may end any of these activities at any time.

These activities by the underwriters may stabilize, maintain or otherwise affect the market price of the notes and the common stock. As a result, the price of the notes may be higher than the price that otherwise might exist in the open market. If these activities are commenced, they may be discontinued by the underwriters at any time. These transactions may be effected in the over-the-counter market or otherwise.

The underwriting agreement provides that we will indemnify the underwriters against certain liabilities, including any liabilities under the Securities Act of 1933, or will contribute to any payments the underwriters may be required to make for such liabilities.

We estimate that our share of the total expenses of the offering, excluding underwriting discounts and commissions, will be approximately $900,000.

The underwriters and their affiliates have provided, from time to time, and may continue to provide, investment banking, financial and other services to us, for which we have paid, and intend to pay, customary fees.

INDEPENDENT AUDITORS

Ernst & Young LLP, independent auditors, have audited our consolidated financial statements incorporated by reference in our Annual Report on Form 10-K for the year ended December 31, 2002, as set forth in their report, which is incorporated herein by reference. Our financial statements are incorporated by reference in reliance on Ernst & Young LLP s report, given on their authority as experts in accounting and auditing.

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VALIDITY OF THE NOTES

The validity of the notes offered hereby and of the shares of common stock issuable upon conversion thereof will be passed upon for us by Gibson, Dunn & Crutcher LLP, New York, New York. Davis Polk & Wardwell, New York, New York, is acting as counsel for the underwriters in connection with selected legal matters relating to the securities offered by this prospectus supplement.

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PROSPECTUS

$300,000,000

FLUOR CORPORATION

Debt Securities

We will provide specific terms of these debt securities in supplements to this prospectus. The prospectus supplements may also add, update or change information contained or incorporated by reference in this prospectus. You should read this prospectus and any supplement carefully before you invest.

Investing in these debt securities involves risks that are described in the section captioned Company Risk Factors contained in our Annual Report on Form 10-K for the year ended December 31, 2001.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is September 18, 2002

We have not authorized anyone else to provide you with any information other than the information provided in or incorporated by reference into this prospectus or any prospectus supplement. We cannot assure the reliability of any different information. We are not making an offer of these securities in any state where the offer is not permitted. This prospectus and any prospectus supplement may be updated from time to time, so you should not assume that the information in this prospectus or any prospectus supplement is accurate as of any date other than the date on the front of those documents.

Investing in these securities involves risks that are described in the section captioned Company Risk Factors contained in our Annual Report on Form 10-K for the year ended December 31, 2001.

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ABOUT THIS PROSPECTUS

In this prospectus, all references to we, our, and us refer to Fluor Corporation, a Delaware corporation.

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission utilizing a shelf registration process. Under this shelf process, we may sell any combination of the debt securities described in this prospectus in one or more offerings up to a total dollar amount of $300,000,000. This prospectus provides you with a general description of the debt securities we may offer. Each time we sell debt securities, we will provide a prospectus supplement that will contain specific information about the terms of that offering. The prospectus supplement may also add, update or change information contained in this prospectus. You should read both this prospectus and any prospectus supplement together with additional information described under the caption Where You Can Find More Information below.

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WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and periodic special reports, proxy statements and other information with the SEC. You may read and copy any document we file at the SEC s Public Reference Section at 450 Fifth Street, N.W., Washington, D.C. 20549, and at the following Regional Offices of the SEC: New York Regional Office, 7 World Trade Center, 13th Floor, New York, New York 10048 and Chicago Regional Office, Citicorp Center, 500 West Madison Street, Room 3190, Chicago, Illinois 60661. Copies of these documents may be obtained from the SEC s Public Reference Section at 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. Please call the SEC at 1-800-732-0330 for further information on the public reference rooms. Our SEC filings are also available to the public over the Internet at the SEC s web site at http://www.sec.gov. You may also read copies of these documents at the offices of the New York Stock Exchange.

The SEC allows us to incorporate by reference the information contained in documents that we file with them, which means that we can disclose important information to you by referring you to those documents. The information incorporated by reference is an important part of this prospectus and any prospectus supplement, and information that we file later with the SEC will automatically update and supersede some or all of this information. We incorporate by reference the documents listed below and any future filings made with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 until we sell all of the debt securities.

Our Annual Report on Form 10-K for the year ended December 31, 2001.

Our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2002 and June 30, 2002.

Our Current Report on Form 8-K (File Number 001-16829) dated August 14, 2002.

You may request a copy of these filings, at no cost, by writing or telephoning us at our principal executive offices at the following address:

Fluor Corporation

One Enterprise Drive
Aliso Viejo, California 92656
Attention: Corporate Secretary
(949) 349-2000.

We have filed exhibits with the registration statement that include the form of proposed underwriting agreement and indenture. You should read the exhibits carefully for provisions that may be important to you.

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DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus contains forward-looking statements. For example, statements that relate to our expectations regarding projected earning levels, market outlook, new awards, backlog levels, competition, the adequacy of funds to service debt and the implementation of new strategic initiatives are forward looking in nature. These forward-looking statements reflect our current analysis of existing information, although no assurance can be given that such statements will be realized. Due to unknown risks, our actual results may differ materially from our expectations or projections. As a result, caution must be exercised in relying on forward-looking statements. The factors potentially contributing to such differences include, among others:

Changes in global business, economic, political and social conditions;

Our failure to receive anticipated new contract awards;

Customer cancellations of, or scope adjustments to, existing contracts;

Difficulties or delays incurred in the execution of construction contracts resulting in cost overruns or liabilities;

Customer delays or defaults in making payments;

Difficulties and delays incurred in the implementation of strategic initiatives;

Risks and impacts resulting from our reverse spin-off transaction completed on November 30, 2000 involving Massey Energy Company; and

Competition in the global engineering, procurement and construction industry.

The forward-looking statements are also based on various operating assumptions regarding, among other matters, overhead costs and employment levels that may not be realized. In addition, while most risks affect only future costs or revenues that we anticipate we will receive, some risks may relate to accruals that have already been reflected in earnings. Our failure to receive payments of these accrued earnings could result in charges against future earnings.

Additional information concerning factors that may influence our results can be found in press releases and periodic filings with the Securities and Exchange Commission including the risk factors set forth in the section captioned Company Risk Factors contained in our Annual Report on Form 10-K for the year ended December 31, 2001. These filings are available publicly and upon request from Fluor s Investor Relations Department: (949) 349-3909. We disclaim any intent or obligation to update forward-looking statements.

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THE COMPANY

Fluor Corporation is a leading professional services company offering a diverse range of value-added, knowledge-based services from traditional engineering, procurement and construction services to total asset management. Fluor Corporation is basically a holding company which owns, directly or indirectly, the stock of numerous subsidiary corporations. Fluor Corporation is aligned into five principal operating segments:

(1) The Energy & Chemicals segment provides design, engineering, procurement and construction services on a worldwide basis to an extensive range of oil, gas, refining, chemical, polymer and petrochemical clients;

(2) The Industrial & Infrastructure segment provides design, engineering, procurement and construction services to a broad base of businesses including general industrial, commercial, institutional, manufacturing, infrastructure, telecommunications, mining and technology customers on a global basis;

(3) The Power segment designs, engineers and constructs power facilities globally;

(4) The Global Services segment provides operations and maintenance support, temporary staffing, equipment and outsourcing and asset management solutions to Fluor Corporation s projects as well as to third party clients; and

(5) The Government Services segment provides administration and support services to the federal government and other governmental parties.

Fluor Constructors International, Inc., which is organized and operates separately from our operating segments, provides unionized management, construction and management services in the United States and Canada, both independently and as a subcontractor, on projects to our operating segments.

On November 30, 2000, Fluor Corporation completed a reverse spin-off transaction in which its coal segment, previously operated under its A. T. Massey Coal Company, Inc. subsidiary, was separated from the other business segments of Fluor Corporation.

Fluor Corporation was incorporated in Delaware on September 11, 2000. Fluor Corporation s principal executive offices are located at One Enterprise Drive, Aliso Viejo, California 92656, telephone number (949) 349-2000.

USE OF PROCEEDS

Except as otherwise specified in a prospectus supplement, we will use the net proceeds from the sale of the debt securities for general corporate purposes including working capital, capital expenditures, stock purchase programs, repayment and refinancing of debt and acquisitions. We may invest funds not required immediately for such purposes in marketable securities and short-term investments.

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RATIO OF EARNINGS TO FIXED CHARGES

Our ratios of earnings to fixed charges for each of the four years ended October 31, 2000, the year ended December 31, 2001 and the six months ended June 30, 2002 are as follows:

Year Ended October 31,				Year Ended December 31,	Six Months Ended June 30,
1997	1998	1999	2000	2001	2002
3.59	5.50	2.86	4.10	4.80	8.20

For purposes of computing the ratios of earnings to fixed charges, earnings consist of earnings from continuing operations before provision for income taxes plus fixed charges less equity in earnings from less than 50% owned persons, net of distributions. Fixed charges consist of interest and approximately one-third of rental expense. Please also refer to the section captioned Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2001 and our Quarterly Report on Form 10-Q for the quarter ended June 30, 2002 for a discussion of factors which have affected our earnings from continuing operations before income taxes.

DESCRIPTION OF THE DEBT SECURITIES

The debt securities covered by this prospectus will be our direct unsecured obligations. The debt securities will be issued in one or more series under an indenture, between us and The Bank of New York, as trustee. Because we are a holding company, however, our ability to meet our debt obligations depends upon the earnings of, and dividends and other payments from, our subsidiaries. Furthermore, the debt securities offered hereby will be effectively subordinated to all existing and future liabilities of our subsidiaries. This means that upon the liquidation, reorganization or insolvency of any of our subsidiaries, the claims of creditors and any preferred stockholders will generally take priority over our right to participate as a stockholder in any distribution of the assets of such subsidiary.

This prospectus briefly outlines the material provisions of the indenture. A copy of the form of indenture has been filed as an exhibit to the registration statement. Although this prospectus and the applicable prospectus supplement provide all the information that we believe is material with respect to the debt securities, you should read the indenture for provisions that may be important to you. In the summary below, we have included references to section numbers of the indenture so that you can easily locate these provisions.

General

The debt securities will rank equally with all of our other unsecured and unsubordinated debt. The indenture does not limit the amount of debt we may issue under the indenture or otherwise. We may issue the debt securities in one or more series with the same or various maturities, at par or a premium, or with original issue discount.

The debt securities may be issuable in the form of one or more global securities, as further described under the caption Global Securities below. Except for any debt securities issued in the form of a global security, the debt securities are exchangeable or transferable without charge. We may, however, require you to pay us for any tax or other governmental charge payable in connection with the transfer and exchange and may also require you to furnish appropriate endorsements and transfer documents. (Section 3.05)

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Unless otherwise specified in a prospectus supplement, any principal, premium or interest payment will be payable, and the transfer of debt securities will be registrable, at the principal corporate trust office of the Trustee. In addition, unless otherwise specified in a prospectus supplement and except in the case of any debt securities issued in the form of a global security, we may opt to make interest payments by check, mailed to the address of the person entitled to receive the interest payment as reflected on the security register. (Sections 3.01, 3.05, 10.01 and 10.02)

The prospectus supplement relating to any series of debt securities being offered will include all additional material terms of the offering not otherwise contained in this prospectus. These terms will include some or all of the following:

(1) The title of the debt securities;

(2) The aggregate principal amount of the debt securities;

(3) The person to whom any interest on the debt securities will be payable, if other than the person in whose name it is registered on the regular record date for such interest;

(4) The date or dates on which the principal of the debt securities will be payable or the method for determining such date or dates and any rights of extension;

(5) The interest rate or rates at which the debt securities will bear interest, if any, and the date or dates from which such interest will accrue, the interest payment dates for the debt securities and the regular record dates for any interest payable on any interest payment date;

(6) The place or places where the principal of and any interest on the debt securities are payable;

(7) The terms and conditions of any optional or mandatory redemption provisions;

(8) The terms and conditions of any sinking fund or other analogous provision that would obligate us to redeem or repurchase the debt securities, in whole or in part, and any remarketing provisions for the debt securities;

(9) The denominations in which the debt securities will be issuable, if other than denominations of $1,000 or any integral multiple thereof;

(10) Any index or formula by which the amount of the principal, any premium or interest payments on the debt securities will be determined and the identity of any calculation agent;

(11) The currency in which the principal, any premium or interest payments on the debt securities will be paid, if other than United States dollars;

(12) The amount of principal payable upon acceleration of the debt securities following an Event of Default, if other than the entire principal amount;

(13) Any amount which will be deemed to be the principal amount of the debt securities as of a particular maturity date or the manner in which the principal amount is to be determined, if the principal amount payable at the maturity date will not be determinable prior to the maturity date;

(14) Any changes to the defeasibility of the debt securities;

(15) Whether the debt securities are to be issued in whole or in part in the form of one or more global securities held by a depositary on behalf of holders or in the form of individual certificates to be held by each holder and the circumstances under which any global security may be exchanged for debt securities;

(16) Any additions to or changes in the Events of Default which apply to the debt securities and any changes in the right of the Trustee or the holders of the debt securities to accelerate the maturity of the debt securities;

(17) Any changes to the definition of Business Day with respect to the debt securities;

(18) Whether the satisfaction of other conditions, in addition to those specified in the indenture, are required and the terms of the conditions;

(19) Any terms or conditions upon which holders may convert or exchange the debt securities into shares of our common stock or other securities or property;

(20) Any additions to or changes in the covenants set forth in the indenture;

(21) Any other specific terms of the debt securities.
(Section 3.01)

The debt securities may be issued with original issue discount, which means that the debt securities may be sold at a discount below their principal amount. Even if debt securities are not issued at a discount below their principal amount, the debt securities may, for United States Federal income tax purposes, be deemed to have been issued with original issue discount because of their interest payment characteristics. United States Federal income tax and other considerations applicable to debt securities issued with original issue discount will be described in the prospectus supplement relating to those debt securities. In addition, United States Federal tax considerations or other terms or restrictions applicable to debt securities which are denominated in a currency other than United States dollars will be described in the prospectus supplement relating to those debt securities.

Consolidation, Merger or Sale

We have agreed not to consolidate with or merge with or into any other entity or convey, transfer or lease substantially all of our properties and assets to any person, unless:

(1) either

(a) we are the continuing corporation, or

(b) the successor or purchaser

is a corporation, partnership or trust organized and validly existing under the laws of the United States or any State thereof or the District of Columbia, and

expressly assumes, by a supplemental indenture, all of our obligations with respect to the debt securities and the indenture;

(2) immediately after such transaction, no Event of Default exists;

(3) if, as a result of any such transaction, our properties or assets would become subject to a lien which would not be permitted by the indenture, we or our successor, as applicable, secures the debt securities equally and ratably with debt secured by such lien; and

(4) other conditions specified in the indenture are met.
(Section 8.01)

The successor entity would succeed to and would be able to exercise every right and power that we possess under the indenture. Except in the case of a lease of substantially

all of our properties and assets, we will thereafter be relieved of all obligations and covenants under the indenture and the debt securities. (Section 8.02)

Modification of Indenture

There are three categories of changes that we can make to the indenture and the debt securities. First, there are changes that cannot be made to the debt securities without the approval of each holder of debt securities affected by the change. Second, there are changes that can be made with the approval of holders of debt securities owning a majority in aggregate principal amount of the outstanding debt securities of all series affected by the change (voting as one class). All other changes may be made by us without the consent or vote of holders of the debt securities.

The following is a summary of the changes that cannot be made without the approval of each holder of debt securities affected by the change:

(1) changes to the time for paying principal or interest on any debt security;

(2) reductions in the amount of principal of or interest on any debt security;

(3) reductions in the amount of premium payable upon the redemption of a debt security;

(4) reductions in the amount of principal of a debt security issued with original issue discount or any other debt security that would be due and payable upon acceleration of the maturity date;

(5) changes to the place where, or the currency in which, any debt security is payable;

(6) impairment of the right to sue for the payment of any debt security;

(7) reductions in the percentage of aggregate principal amount of debt securities of any series, the consent of the holders of which is required to modify or amend the indenture; or

(8) modifications to provisions relating to the requirements for waiving compliance with some provisions or some defaults. (Section 9.02)

Holders of debt securities owning a majority in aggregate principal amount of the outstanding debt securities of all series affected by a change (voting as one class) may, on behalf of the holders of all debt securities of the series, waive:

(1) compliance by us with certain provisions of the indenture; (Section 10.09)

(2) any past default under the indenture with respect to debt securities of the series, except a default (a) in the payment of principal of, or any premium or interest on, any debt security of the series, or (b) in respect of a covenant or provision of the indenture which cannot be modified without the consent of each holder of debt securities of a series affected by the modification. (Section 5.13)

In determining whether the holders of the requisite aggregate principal amount of the outstanding debt securities have given, made or taken any request, demand, authorization, direction, notice, consent, waiver or other action,

(1) the principal amount of a debt security issued with original issue discount will be deemed to be the amount of the principal which would be then due and payable;

(2) if the principal amount payable at the stated maturity date of a debt security is not determinable, the principal amount of the debt security will be deemed to be the amount established in the applicable supplemental indenture;

(3) the principal amount of a debt security denominated in one or more foreign currencies or currency units will be deemed to be the U.S. dollar equivalent of the principal amount of the debt security, determined

in the manner established in the applicable supplemental indenture or

in the case of a debt security described in clause (1) or (2) above, as provided in that clause; and

(4) debt securities owned by us, any of our affiliates or any other obligor will be disregarded. In determining whether the Trustee will be protected in relying upon any request, demand, authorization, direction, notice, consent, waiver or other action, only debt securities which the Trustee knows to be so owned will be disregarded. Debt securities so owned which have been pledged in good faith may be regarded as outstanding if the pledgee establishes to the satisfaction of the Trustee the pledgee s right to so act with respect to the debt securities and that the pledgee is not us, an affiliate of ours or any other obligor.
(Section 1.02)

Events of Default

The following will be Events of Default under the indenture with respect to the debt securities of any series, unless otherwise specified in a prospectus supplement:

(1) failure to pay any interest when due and payable, and the failure continues for 30 days;

(2) failure to pay principal or any premium at the maturity date;

(3) failure to deposit any sinking fund payment, when and as due, and the failure continues for 30 days;

(4) except as otherwise specified by the indenture or with respect to a covenant included solely for the benefit of debt securities other than that series, failure to perform any other of our covenants under the indenture, and the failure continues for 90 days after written notice as provided under the indenture;

(5) some events in bankruptcy, insolvency or reorganization;

(6) any other Event of Default provided with respect to debt securities of that series.
(Section 5.01)

If an Event of Default exists with respect to any series of debt securities, then either the Trustee or the holders of at least 25% in aggregate principal amount of the debt securities of the series may declare the entire principal amount of all the debt securities of that series immediately due and payable. If the Event of Default involves events in bankruptcy, insolvency or reorganization (as described in clause (5) in the paragraph above), then the principal amount of all the debt securities of that series will automatically, and without any declaration or other action on the part of the Trustee or any holder, become immediately due and payable. If any debt securities of a series are issued with original issue discount, the amount of the debt securities that will become immediately due and payable in an Event of Default will be the portion of the principal amount specified by the terms of the debt securities. At any time after the Trustee or the

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holders have declared an acceleration of a series of debt securities, but before a judgment or decree for payment of money has been obtained by the Trustee, the holders of a majority in aggregate principal amount of the debt securities of that series may, under some circumstances, rescind and annul the acceleration. (Section 5.02)

Subject to the provisions of the Trust Indenture Act, the indenture provides that the Trustee will be under no obligation to exercise any of its rights or powers under the indenture at the request or direction of any of the holders, unless the holders have offered to the Trustee reasonable security or indemnity against the costs, expenses and liabilities which might be incurred by it in compliance with the holders request or direction. (Sections 6.01 and 6.03) What will be deemed to constitute reasonable indemnity may vary depending on what rights or powers the holders have requested or directed the Trustee to exercise. Subject to the Trustee s right to indemnification, the holders of a majority in aggregate principal amount of the debt securities of any series will have the right to direct the time, method and place of conducting any proceeding for any remedy available to the Trustee, with respect to the debt securities of that series. (Section 5.12)

We are required to furnish to the Trustee an annual statement by our officers as to whether we have defaulted in the performance of our obligations under the indenture. In the event that we are in default, we are required to specify the nature and status of the default. (Section 10.04)

The right of any holder to receive principal, any premium and interest payments on the debt securities or to institute suit for the enforcement of such payment cannot be impaired without that holder s consent. (Section 5.08)

Conversion Rights

We may issue debt securities that are convertible into our common stock or other securities or property. The specific terms on which the debt securities are convertible will be described in an applicable prospectus supplement. The terms will include provisions as to whether conversion is mandatory or optional and may include provisions that establish the amount of securities or property that you will receive according to a formula based upon the market price of the securities or property at a particular time.

Global Securities

We may issue some or all of the debt securities of a series in the form of one or more global securities. Global securities will be deposited with a depository identified in the applicable prospectus supplement. A global security is a security, typically held by a depository, that represents the beneficial interests of a number of purchasers of the security. The specific terms of the depositary arrangement with respect to a series of debt securities will be described in an applicable prospectus supplement.

Defeasance

The following provisions relating to defeasance and discharge of indebtedness, or relating to defeasance of covenants in the indenture, will apply to the debt securities of any series, or to any specified part of a series, unless otherwise specified in a prospectus supplement. (Section 13.01)

Defeasance and Discharge. We may discharge all of our obligations with respect to the debt securities by depositing in trust, for the benefit of the holders of the debt securities, money or U.S. government obligations, or both, which will provide a sufficient

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amount of money to pay any installment of principal, premium or interest payment and any mandatory sinking fund payment required by the debt securities on the designated payment dates. We may defease and discharge our obligations only if, among other things, there has been a United States Internal Revenue Service ruling, or there has been a change in tax law, to the effect that holders of debt securities will be subject to Federal income tax on the same amount, in the same manner and at the same times as would have been the case if such deposit, defeasance and discharge were not to occur. We may not, however, discharge our obligations to exchange or register the transfer of debt securities, to replace stolen, lost or mutilated debt securities, to maintain paying agencies or to hold moneys for payment in trust. (Sections 13.02 and 13.04)

Defeasance of Covenants. Under some circumstances, we may not be required to comply with the restrictive covenants that may be described in this prospectus or any applicable prospectus supplement. In addition, under some circumstances, the occurrence of some Events of Default, including any that may be described in an applicable prospectus supplement, will be deemed not to be or result in an Event of Default. In order for this to occur, we must deposit in trust, for the benefit of the holders of debt securities, money or U.S. government obligations, or both, which will provide a sufficient amount of money to pay any installment of principal, premium or interest payment and any mandatory sinking fund payment required by the debt securities on the designated payment dates. There must also have been, among other things, a United States Internal Revenue Service ruling, or a change in tax law, to the effect that holders of debt securities will be subject to Federal income tax on the same amount, in the same manner and at the same times as would have been the case if such deposit, defeasance and discharge were not to occur.

In the event we exercised this option with respect to any debt securities and the debt securities were accelerated and declared due and payable as a result of an Event of Default, the amount of money and U.S. government obligations deposited in trust may not be sufficient to pay amounts due on the debt securities at the time of the acceleration. In that case, we would remain liable for any amounts still due. (Sections 13.03 and 13.04)

Acceptable U.S. government obligations are limited under the indenture to:

(a) any security which is

- a direct obligation of the United States of America for the payment of which the full faith and credit of the United States of America is pledged, or

- an obligation of an entity controlled or supervised by and acting as an agency or instrumentality of the United States of America the payment of which is unconditionally guaranteed as a full faith and credit obligation by the United States of America,

which is not callable or redeemable at the option of the issuer, and

(b) any depositary receipt issued by a bank as custodian with respect to any U.S. government obligation which is specified in clause (a) above and held by the bank for the account of the holder of the depositary receipt, or with respect to any specific payment of principal of or interest on any U.S. government obligation which is so specified and held.

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Concerning the Trustee

Upon the occurrence of an Event of Default or an event which, after notice or lapse of time or both, would become an Event or Default, the Trustee may be deemed to have a conflicting interest with respect to the debt securities for purposes of the Trust Indenture Act. In that event, unless the Trustee is able to eliminate the conflicting interest, the Trustee may be required to resign as Trustee under the indenture. If the Trustee resigns, we will be required to appoint a successor Trustee for the indenture.

Governing Law

The debt securities and the indenture will be governed by, and construed in accordance with, the laws of the State of New York.

PLAN OF DISTRIBUTION

We may sell debt securities from time to time in one or more transactions. We may sell debt securities (a) through underwriters or dealers; (b) through agents; or (c) directly to one or more purchasers.

Sale Through Underwriters

If we use underwriters in the sale, the underwriters will acquire the debt securities for their own account. The underwriters may resell the debt securities in one or more transactions, including negotiated transactions, at a fixed public offering price or at varying prices determined at the time of sale. The obligations of the underwriters to purchase the debt securities will be subject to conditions. The underwriters will be obligated to purchase all the debt securities of a series offered by a prospectus supplement if any of such debt securities are purchased. The underwriters may sell debt securities to or through dealers, and such dealers may receive compensation in the form of discounts, concessions or commissions from the underwriters. The underwriters may change from time to time any initial public offering price and any discounts, concessions or commissions allowed or re-allowed or paid to dealers.

Sale Through Agents

We may sell debt securities through agents designated by us. Unless indicated in the prospectus supplement, the agents have agreed to use their reasonable best efforts to solicit purchases for the period of their appointment.

Direct Sales

We also may sell debt securities directly to purchasers without the involvement of underwriters or agents.

General Information

We may authorize agents, underwriters or dealers to solicit offers by institutional investors to purchase debt securities providing for payment and delivery on a future date specified in the prospectus supplement. Institutional investors to which such offers may be made, when authorized, include commercial and savings banks, insurance companies, pension funds, investment companies, educational and charitable institutions and other institutions that are approved by us. The obligations of any purchasers under delayed delivery and payment arrangements will not be subject to any conditions except that

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(1) the purchase by an institution of the debt securities will not at delivery be prohibited under the laws of any jurisdiction in the United States to which the institution is subject and (2) if the debt securities are being sold to underwriters, we will sell to the underwriters the total principal amount of the debt securities less the principal amount covered by the delayed delivery and payment arrangement.

Underwriters, dealers and agents that participate in the distribution of the offered securities may be underwriters as defined in the Securities Act of 1933, and any discounts or commissions received by them from us and any profit on the resale of the debt securities by them may be treated as underwriting discounts and commissions under the Securities Act of 1933. We will identify any underwriters or agents, and describe their compensation, in a prospectus supplement.

The debt securities may or may not be listed on a national securities exchange or a foreign securities exchange. The debt securities will be a new issue of securities with no established trading market. Any underwriters or agents to or through whom we sell debt securities for public offering and sale may make a market in the debt securities. However, the underwriters and agents will not be obligated to make a market in the debt securities and may discontinue their market-making activities at any time without notice. We cannot provide any assurance with respect to the liquidity of the trading market for any of the debt securities.

We may have agreements with the underwriters, dealers and agents to indemnify them against civil liabilities, including liabilities under the Securities Act of 1933, or to contribute to payments which the underwriters, dealers or agents may be required to make.

Underwriters, dealers and agents may engage in transactions with, or perform services for, us or our subsidiaries in the ordinary course of their businesses.

LEGAL MATTERS

Gibson, Dunn & Crutcher LLP, our outside legal counsel, will issue an opinion about the legality of the debt securities for us. Any underwriters will be advised about other issues relating to any offering of debt securities by their own legal counsel.

EXPERTS

Ernst & Young LLP, independent auditors, have audited our consolidated financial statements incorporated by reference in our Annual Report on Form 10-K for the year ended December 31, 2001, as set forth in their report, which is incorporated herein by reference. Our financial statements are incorporated by reference in reliance on Ernst & Young LLP s report, given on their authority as experts in accounting and auditing.

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$300,000,000

Fluor Corporation

1.50% Convertible Senior Notes due 2024

PROSPECTUS SUPPLEMENT

February 11, 2004

Joint Book-Running Managers

Banc of America Securities LLC

Citigroup

Senior Co-Manager

Lehman Brothers

BNP PARIBAS

line; FONT-FAMILY: times new roman; FONT-SIZE: 10pt">

	19,379,381
Short-term debt	
	4,493,434
	5,842,924
	4,606,361
	4,867,864
	6,327,453
Long-term debt (6)	
	12,151,967
	11,293,249

12,054,497

12,720,055

10,173,587

Subordinated deferrable debt

186,440

186,440

311,440

311,440

311,440

Members' subordinated certificates (7)

1,722,744

1,801,212

1,810,715

1,740,054

1,406,779

Members' equity (8)

814,683

790,241

669,355

604,316

613,082

Total equity

490,755

687,309

586,767

519,100

680,212

Guarantees

1,249,330

1,104,988

1,171,109

1,275,455

1,037,140

Leverage ratio (4)

42.20

30.52

35.33

41.88

29.01

Adjusted leverage ratio (5)

6.46

6.48

6.34

7.06

7.48

Debt-to-equity ratio (4)

39.65

28.92

33.33

39.42

27.49

Adjusted debt-to-equity ratio (5)	6.01	6.09	5.93	6.59	7.04

(1) Amount represents changes in the fair value of derivative instruments (forward value) along with realized gains and losses from cash settlements. Derivative cash settlements represent the net settlements received/paid on interest rate and cross currency exchange agreements that do not qualify for hedge accounting. The derivative forward value represents the change in fair value on exchange agreements that do not qualify for hedge accounting, as well as amortization related to the transition adjustment recorded as an other comprehensive loss on June 1, 2001.
(2) Includes a one-time gain of $23 million from the proceeds of a settlement with CoBank, ACB, for the year ended May 31, 2010.
(3) For the years ended May 31, 2012, 2011, 2010 and 2009, the fixed-charge coverage ratio includes capitalized interest in total fixed charges, which is not included in our times interest earned ratio ("TIER") calculation. For the year ended prior to May 31, 2009, the fixed-charge coverage ratio is the same calculation as our TIER as we did not have any capitalized interest during that period. For the years ended May 31, 2012 and 2009, earnings were insufficient to cover fixed charges by $149 million and $74 million, respectively.
(4) See Non-GAAP Financial Measures in Management's Discussion and Analysis for the GAAP calculations of these ratios.
(5) Adjusted ratios include non-GAAP adjustments that we make to financial measures in assessing our financial performance. See Non-GAAP Financial Measures in Management's Discussion and Analysis for further explanation of these calculations and a reconciliation of the adjustments.
(6) Excludes $1,247 million, $2,523 million, $2,312 million, $2,580 million, and $3,177 million in long-term debt that comes due, matures and/or will be redeemed during fiscal years 2013, 2012, 2011, 2010, and 2009, respectively (see Note 5 to the consolidated financial statements).
(7) Excludes $17 million and $12 million of members' subordinated certificates reported as short-term debt at May 31, 2012 and 2011, respectively.
(8) Members' equity represents total equity excluding foreign currency adjustments, derivative forward value, accumulated other comprehensive income and noncontrolling interest. See the Financial Condition/Liabilities and Equity section in Management's Discussion and Analysis for further details of members' equity and a reconciliation to total equity.

Item 7. 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 consolidated financial condition and results of operations and as such should be read in conjunction with the consolidated financial statements, including the notes thereto and the information contained elsewhere in this Form 10-K, including Part I, Item 1A. Risk Factors.

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.

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 CFC member 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 member-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 May 31, 2012, decreased by $413 million from the prior fiscal year end. During the first half of fiscal year 2012, there was a decrease in loans outstanding of $1,010 million, primarily due to $632 million of repayments mainly on power supply bridge loans and a $200 million telephone loan that matured. During the second half of fiscal year 2012, loan advances exceeded repayments by $597 million, primarily driven by the refinancing of other lenders' debt and new bridge loan advances. At May 31, 2012, long-term fixed-rate loans totaled $16,743 million, or 89 percent, of loans outstanding, compared with $16,405 million, or 85 percent, of loans outstanding at the prior year-end. The primary reason for the increase in long-term fixed-rate loans was the placement on accrual status of the $420 million CoServ restructured loan at a fixed rate of 4.85 percent on October 1, 2011.

During the year ended May 31, 2012, $1,683 million of CFC long-term fixed-rate loans were scheduled to reprice. Of this total, $1,338 million selected a new long-term fixed rate; $220 million selected a long-term variable rate; $52 million selected a new rate offered as part of our loan sales program and were sold by CFC with CFC continuing to service the loans sold; and $73 million were prepaid in full.

Funding Activity

During the year ended May 31, 2012, total debt outstanding decreased by $569 million. The primary reason for the decrease was the $1,233 million reduction to medium-term notes outstanding during the year offset by $800 million of new collateral trust bonds issued during the year. During the first half of fiscal year 2012, we redeemed early a total of $500 million of medium-term notes that had an original maturity date of March 1, 2012. On March 1, 2012, the remaining $1,000 million of the medium-term notes matured for a total reduction of $1,500 million during the year. Due to the lower loan balances during the year, we did not need to refinance the entire $1,500 million of medium-term notes. At May 31, 2012 and 2011, commercial paper, daily liquidity fund and bank bid notes outstanding represented 17 percent of total debt outstanding. At May 31, 2012 and 2011, collateral trust bonds represented 34 percent and 29 percent, respectively, of total debt outstanding while medium-term notes represented 13 percent and 19 percent, respectively, of total debt outstanding. Declining loan balances during the year reduced the amount of debt funding required; however, we were able to maintain the same utilization

of commercial paper, daily liquidity fund and bank bid notes, while replacing higher cost maturing medium-term notes with new issuances of lower cost collateral trust bonds.

The $569 million decrease in total debt outstanding at May 31, 2012 was greater than the $413 million reduction to loans outstanding. The additional decrease in debt funding reflects a cash balance that was $102 million lower at May 31, 2012 as compared with the prior year-end. The cash balance was managed lower at year end to more effectively utilize cash.

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 totaled $2,845 million at May 31, 2012. The fees on the new agreements are lower resulting in savings to us. Additionally, the maturity of the two new commitments will occur in October 2015 and 2016 compared with March 2012 and 2013 under the old commitments.

Financial Results
For the years ended May 31, 2012 and 2011, we reported a net loss of $149 million and net income of $151 million, respectively, and TIER of less than 1.00 and 1.18, respectively. As previously mentioned, we use adjusted non-GAAP measures in our analysis to evaluate our performance and for debt covenant compliance. For the years ended May 31, 2012 and 2011, our adjusted net income was $75 million and $175 million, respectively, and adjusted TIER was 1.10 and 1.21, respectively. The decrease in our adjusted net income was primarily due to a $65 million reduction to the recovery from the loan loss allowance and a $45 million impairment charge recorded related to our Caribbean Asset Holdings LLC ("CAH") subsidiary during the third quarter of fiscal year 2012.

We experienced an increase of $25 million, or 16 percent, to our adjusted net interest income for the year ended May 31, 2012 as compared with the prior year. During the first half of fiscal year 2012, we redeemed early a total of $500 million of medium-term notes that had an original maturity date of March 1, 2012. The early redemption provided an estimated savings of approximately $16 million to our adjusted interest expense. We also recorded a charge in non-interest expense of $16 million to record the early redemption premium and to write off unamortized issuance costs. Therefore, excluding the early redemption savings that are offset by non-interest expenses, we experienced an increase of $9 million, or 6 percent, to our adjusted net interest income. The primary reason for the increase of $9 million to our adjusted net interest income was refinancing activity.

For the year ended May 31, 2012, we recorded a recovery of loan losses totaling $18 million, a decrease of $65 million from the recovery in 2011. The higher recovery for the year ended May 31, 2011 was due to reductions in the allowance for loan losses held for the impaired and general loan portfolios driven by the higher fair value of collateral securing impaired loans, principal repayments on impaired loans, improvement in the borrowers' average internal risk rating, as well as updated credit default information and a lower weighted average maturity for the loans in the general portfolio.

During the third quarter of fiscal year 2012, we recorded impairment charges for goodwill and other assets related to our 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 $20 million related to the operations of CAH for the year ended May 31, 2012, compared with a net loss of $12 million, for the prior year. CAH took control of a non-performing borrower's 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 credit facility agreements.

At May 31, 2012, our debt-to-equity ratio increased to 39.65 -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 decreased to 6.01 -to-1 at May 31, 2012 compared with 6.09-to-1 at May 31, 2011 primarily due to a decrease in our total liabilities partially offset by the decrease in adjusted equity.

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 expect earnings from core lending operations to be fairly stable over the next 12 months.

We have $1,247 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 May 31, 2012, we had up to $580 million available under committed loan facilities from the Federal Financing Bank, $2,844 million available under committed revolving lines of credit with a syndicate of banks and, subject to market

conditions, up to $2,735 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 continue to roll over the $3,247 million of commercial paper, daily liquidity fund and bank bid notes scheduled to mature through May 31, 2013, 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.

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.

Critical Accounting Policies and Estimates

Our significant accounting principles, as described in Note 1, General Information and Accounting Polices, to the consolidated financial statements are essential in understanding Management's Discussion and Analysis of Financial Condition and Results of Operations. Many of our significant accounting principles require complex judgments to estimate values of assets and liabilities. We have procedures and processes to facilitate making these judgments.

We identified the allowance for loan losses and the determination of fair value of certain items on our balance sheet as critical accounting policies because they require significant estimations and judgments by management. These policies are summarized below and identify and describe the development of the variables most important in the estimation process. In many cases, there are numerous alternative judgments that could be used in the process of determining the inputs required for estimation. Where alternatives exist, we used the factors we believe represent the most reasonable value in developing the inputs. Actual performance that differs from our estimates of the key variables could affect net income. Separate from the possible future effect to net income from our model inputs, market-sensitive assets and liabilities may change subsequent to the balance sheet date, often significantly, due to the nature and magnitude of future credit and market conditions. Such credit and market conditions may change quickly and in unforeseen ways, and the resulting volatility could have a significant, negative effect on future operating results.

Below is a description of the process used in determining the adequacy of the allowance for loan losses and the determination of fair value for certain items on our balance sheet.

Allowance for Loan Losses
GAAP requires loans receivable to be reported on the consolidated balance sheets at net realizable value. The net realizable value is the total principal amount of loans outstanding less an estimate of the probable losses inherent in the portfolio. We maintain an allowance for loan losses at a level estimated by management to provide for probable losses inherent in the loan portfolio. The allowance for loan losses is reported separately on the consolidated balance sheet, and the provision for loan losses is reported as a separate line item on the consolidated statement of operations.

There are significant subjective assumptions and estimates used in calculating the amount of the loss allowance required. We review the estimates and assumptions used in the calculations of the loan loss allowance on a quarterly basis. Because of the subjective nature of these estimates, other estimates could be reasonable, and changes in the assumptions used and our estimates could have a material effect on our financial statements. The estimate of the allowance for loan losses is based on a review of the composition of the loan portfolio, past loss experience, specific problem loans, current economic conditions, available market data and/or projection of future cash flows and other pertinent factors that in management's judgment may contribute to expected losses. The methodology used to calculate the loan loss allowance is summarized below.

The loan loss allowance is calculated by dividing the portfolio into two categories of loans:

(1) the general portfolio, which comprises loans that are performing according to the contractual agreements; and
(2) the impaired portfolio, which comprises loans that (i) are not currently performing or (ii) for various reasons we do not expect to collect all amounts as and when due and payable under the loan agreement or (iii) are performing according to a restructured loan agreement, but as a result of the troubled debt restructuring are required to be classified as impaired.

General Portfolio

The general portfolio of loans consists of all loans not specifically identified in the impaired category. We disaggregate the loans in the general portfolio by company: CFC, RTFC and NCSC. We further disaggregate the CFC loan portfolio by member class: distribution, power supply and statewide and associates.

We use the following factors to determine the loan loss allowance for the general portfolio category:

- Internal risk ratings system. We maintain risk ratings for our borrowers that are updated at least annually and are based on the following:
  - general financial condition of the borrower;
  - our estimate of the adequacy of the collateral securing our loans;
  - our judgment of the quality of the borrower's management;
  - our judgment of the borrower's competitive position within its service territory and industry;
  - our estimate of the potential impact of proposed regulation and litigation; and
  - other factors specific to individual borrowers or classes of borrowers.
- Standard & Poor's historical corporate bond default table. The table provides expected default rates for all corporate bonds based on rating level and the remaining maturity. We correlate our internal risk ratings to the ratings used in the corporate bond default table. We use the default table to assist in estimating our loan loss allowance because we have limited history from which to develop loss expectations.
- Recovery rates. Estimated recovery rates are based on our historical recovery experience by member class calculated by comparing loan balances at the time of default to the total loss recorded on the loan. We have been lending to electric cooperatives since our incorporation in 1969.

In addition to the loan loss allowance for the general portfolio, we maintain an unallocated reserve for the general portfolio. Our unallocated reserve has two components:

- A single-obligor reserve to cover the additional risk associated with large loan exposures. This component of unallocated reserve is based on our internal risk ratings and applied to exposures above an established threshold.
- An economic and environmental reserve to cover factors we believe are currently affecting the financial results of borrowers but are not reflected in our internal risk rating process and, therefore, present an increased risk of losses incurred as of the balance sheet date. We use annual audited financial statements from our borrowers as part of our internal risk rating process. There could be a lag between the time various environmental and economic factors occur and the time when these factors are reflected in the annual audited financial statements of the borrower and, therefore, the internal risk rating we determine for the borrower. Our Corporate Credit Committee makes a quarterly determination of the percentage to apply to loans in the general portfolio as an additional reserve. This reserve component may be set at up to 10 percent of the amount of the calculated general loan loss allowance for each type of loan exposure. The Corporate Credit Committee takes into consideration the effect on our borrowers from (i) the economic downturn, (ii) the increase in the unemployment rate, (iii) the decline in the housing market that led to a significant increase in foreclosures and (iv) specifically for telecommunications borrowers, reduced discretionary spending for telecommunications services, increased competition from wireless providers and continued loss of access lines among rural local exchange carriers.

Impaired Loans

A loan is considered to be impaired when we do not expect to collect all principal and interest payments as scheduled by the original loan terms, other than an insignificant delay or an insignificant shortfall in amount. Factors considered in determining impairment may include, but are not limited to:

- the review of the borrower's audited financial statements and interim financial statements if available,
- the borrower's payment history,
- communication with the borrower,
- economic conditions in the borrower's service territory,
- pending legal action involving the borrower,
- restructure agreements between us and the borrower and
- estimates of the value of the borrower's assets that have been pledged as collateral to secure our loans.

An impairment loss on a loan receivable is recognized as the difference between the recorded investment in the loan and the present value of the estimated future cash flows associated with the loan discounted at the effective interest

rate on the loan at the time of impairment. If the current balance in the receivable is greater than the net present value of the future payments discounted at the effective interest rate at the time the loan became impaired, the impairment is equal to that difference and a portion of the loan loss allowance is specifically reserved based on the calculated impairment. If future cash flows cannot be estimated, the loan is collateral dependent or foreclosure is probable, the impairment is calculated based on the estimated fair value of the collateral securing the loan.

In calculating the impairment on a loan, the estimates of the expected future cash flows or collateral value are the key estimates made by management. Changes in the estimated future cash flows or collateral value affect the amount of the calculated impairment. The change in cash flows required to make the change in the calculated impairment material will be different for each borrower and depend on the period covered, the effective interest rate at the time the loan became impaired and the amount of the loan outstanding. Estimates are not used to determine our investment in the receivables or the discount

rate since, in all cases, the investment is equal to the loan balance outstanding at the reporting date, and the discount rate is equal to the interest rate on the loan at the time the loan became impaired.

Our policy for recognizing interest income on impaired loans is determined on a case-by-case basis. An impaired loan to a borrower that is non-performing will typically be placed on non-accrual status and we will reverse all accrued and unpaid interest. We generally apply all cash received during the non-accrual period to the reduction of principal, thereby foregoing interest income recognition. Interest income may be recognized on an accrual basis for restructured impaired loans where the borrower is performing and is expected to continue to perform based on agreed-upon terms.

All loans are written off in the period that it becomes evident that collectability is highly unlikely; however, our efforts to recover all charged-off amounts may continue. The determination to write off all or a portion of a loan balance is made based on various factors on a case-by-case basis including, but not limited to, cash flow analysis and the fair value of collateral securing the borrower's loans.

The loan loss reserve is an estimate of probable losses inherent in the loan portfolio. At May 31, 2012, our general reserve of $97 million represented 0.53 percent of the outstanding balance of loans covered by the general reserve. Based on this coverage level, an increase or decrease of $500 million in loans covered by the general reserve would result in a corresponding increase or decrease of $2.7 million to the loan loss allowance.

Fair Value
We determined the accounting for certain items on our balance sheet at fair value to be a critical accounting policy because of the subjective nature and the requirement for management to make significant estimations in determining the amounts to be recorded. Different assumptions and estimates could also be reasonable, and changes in the assumptions used and estimates made could have a material effect on our financial statements.

The primary instruments recorded on our balance sheet at fair value are derivative financial instruments. Derivative instruments must be recorded on the balance sheet as either an asset or liability measured at fair value. Since these instruments generally do not qualify for hedge accounting, the accounting standards require that we record all changes in fair value through earnings. We record the change in the fair value of derivatives instruments, along with realized gains and losses from cash settlements, in the derivative losses line item of the consolidated statement of operations each reporting period.

Since there is not an active secondary market for the types of derivative instruments we use, we obtain market quotes from our dealer counterparties. The market quotes are based on the expected future cash flow and estimated yield curves. We perform our own analysis to confirm the values obtained from the counterparties. The counterparties estimate future interest rates as part of the quotes they provide to us. We adjust all derivatives to fair value on a quarterly basis. The fair value we record will change as estimates of future interest rates change. To estimate the impact of changes to interest rates on the forward value of derivatives, we would need to estimate all changes to interest rates through the maturity of our outstanding derivatives. The maturities of our derivatives in the current portfolio run through 2045. Since many of the derivative instruments we use for risk management have such long-dated maturities, the valuation of these derivatives may require extrapolation of market data that is subject to significant judgment. Accounting standards on fair value require that credit risk be considered in determining the market value of any asset or liability carried at fair value. We adjust the market values of our derivatives received from the counterparties based on our counterparties' and our credit spreads observed in the credit default swap market.

In addition to the valuation associated with derivative financial instruments, we also present foreclosed assets at fair value when initially recorded on the balance sheet. Foreclosed assets that do not qualify as assets held for sale are periodically reviewed for impairment. If an impairment loss is recognized on our foreclosed assets, the adjusted carrying amount of the foreclosed assets becomes the new cost basis. Restoration of any recognized impairment loss is

prohibited under GAAP, even when the fair value of the foreclosed assets increases subsequent to our recognition of impairment. Subsequent increases in fair value on certain foreclosed assets including those that qualify as held for sale are recorded as gains, and are limited to the cumulative amount of loss in fair value recognized in prior periods.

In many instances the valuation of these assets is judgmental and dependent upon comparisons to similar assets or estimations of future cash flows that are expected to be generated by the underlying foreclosed properties. In both of these instances, management uses its best estimates, based upon available market data and/or projections of future cash flows. However, because of the subjective nature of these estimates, other estimates could be reasonable, and changes in the assumptions used and our estimates could have a material effect on our financial statements.

Results of Operations

The following table presents the results of operations for the years ended May 31, 2012, 2011 and 2010.

	For the years ended May 31,			Change from the previous year	
(dollar amounts in thousands)	2012	2011	2010	2012 vs. 2011	2011 vs. 2010
Interest income	$ 960,961	$ 1,008,911	$ 1,043,635	$ (47,950)	$ (34,724)
Interest expense	(761,778)	(841,080)	(912,111)	79,302	71,031
Net interest income	199,183	167,831	131,524	31,352	36,307
Recovery of loan losses	18,108	83,010	30,415	(64,902)	52,595
Net interest income after recovery of loan losses	217,291	250,841	161,939	(33,550)	88,902
Non-interest income:					
Fee and other income	17,749	23,646	17,711	(5,897)	5,935
Settlement income	-	-	22,953	-	(22,953)
Derivative losses	(236,620)	(30,236)	(20,608)	(206,384)	(9,628)
Results of operations from foreclosed assets	(67,497)	(15,989)	(5,469)	(51,508)	(10,520)
Total non-interest income	(286,368)	(22,579)	14,587	(263,789)	(37,166)
Non-interest expense:					
Salaries and employee benefits	(39,364)	(42,856)	(39,113)	3,492	(3,743)
Other general and administrative expenses	(25,973)	(28,591)	(31,839)	2,618	3,248
(Provision for) recovery of guarantee liability	(726)	673	5,281	(1,399)	(4,608)
Loss on early extinguishment of debt	(15,525)	(3,928)	-	(11,597)	(3,928)
Other	(739)	(1,018)	(604)	279	(414)
Total non-interest expense	(82,327)	(75,720)	(66,275)	(6,607)	(9,445)
(Loss) income prior to income taxes	(151,404)	152,542	110,251	(303,946)	42,291
Income tax benefit (expense)	2,607	(1,327)	296	3,934	(1,623)
Net (loss) income	(148,797)	151,215	110,547	(300,012)	40,668
Less: Net loss (income) attributable to noncontrolling interest	4,070	(1,789)	(235)	5,859	(1,554)
Net (loss) income attributable to CFC	$ (144,727)	$ 149,426	$ 110,312	$ (294,153)	$ 39,114
Adjusted net income	$ 74,977	$ 174,603	$ 107,851	$ (99,626)	$ 66,752
Adjusted interest expense	$ (774,624)	$ (847,928)	$ (935,415)	$ 73,304	$ 87,487
TIER (1)	-	1.18	1.12		
Adjusted TIER (2)	1.10	1.21	1.12		

(1) For the year ended May 31, 2012, we reported a net loss of $149 million and, therefore, the TIER calculation for that period results 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

	Average volume			Interest income			Average yield		
(dollar amounts in thousands)	2012	2011	2010	2012	2011	2010	2012	2011	2010
Long-term fixed-rate loans	$ 16,440,288	$ 16,297,697	$ 15,456,301	$ 878,604	$ 904,464	$ 897,648	5.34 %	5.55 %	5.81 %
Long-term variable-rate loans	658,847	914,979	1,609,562	24,374	45,590	75,330	3.70	4.98	4.68
Line of credit loans	1,072,222	1,415,919	1,652,154	30,717	44,346	56,055	2.86	3.13	3.39
Restructured loans	461,670	487,570	521,570	16,191	2,789	3,188	3.51	0.57	0.61
Non-performing loans	39,953	242,890	523,813	-	149	-	-	0.06	-
Total	18,672,980	19,359,055	19,763,400	949,886	997,338	1,032,221	5.09	5.15	5.22
Investments	334,732	326,774	550,597	3,934	3,830	5,245	1.18	1.17	0.95
Fee income (1)	-	-	-	7,141	7,743	6,169	-	-	-
Total	$ 19,007,712	$19,685,829	$20,313,997	$ 960,961	$1,008,911	$1,043,635	5.06	5.13	5.14

(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.

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	Analysis of changes in interest income					
	2012 vs. 2011			2011 vs. 2010		
	Change due to (3)			Change due to (3)		
(dollar amounts in thousands)	Average volume (1)	Average rate (2)	Net change	Average volume (1)	Average rate (2)	Net change
Increase (decrease) in interest income:						
Long-term fixed-rate loans	$ 7,913	$ (33,773)	$ (25,860)	$ 48,866	$(42,050)	$ 6,816
Long-term variable-rate loans	(12,762)	(8,454)	(21,216)	(32,508)	2,768	(29,740)
Line of credit loans	(10,764)	(2,865)	(13,629)	(8,015)	(3,694)	(11,709)
Restructured loans	(148)	13,550	13,402	(208)	(191)	(399)
Non-performing loans	(124)	(25)	(149)	-	149	149
Total interest income on loans	(15,885)	(31,567)	(47,452)	8,135	(43,018)	(34,883)
Investments	93	11	104	(2,132)	717	(1,415)
Fee income	-	(602)	(602)	-	1,574	1,574
Total interest income	$ (15,792)	$ (32,158)	$ (47,950)	$ 6,003	$(40,727)	$ (34,724)

(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 year ended May 31, 2012, interest income decreased by 5 percent compared with the prior year primarily due to a 6 basis-point decrease in the average rate on loans. During the year ended May 31, 2011, interest income decreased 3 percent compared with the prior year primarily due to a 7 basis-point decrease in the average yield on loans. As a cost-based lender, our fixed interest rates reflect the rates being charged in the capital markets marked up to cover our cost of operations. During fiscal years 2012 and 2011, there was a lower trend in the rates we had to pay for funding in the capital markets as compared with the respective prior years. During the year ended May 31, 2012, $1,683 million of long-term fixed-rate loans were scheduled to reprice and the borrowers of $1,338 million of these loans selected a new long-term fixed rate, which was on average lower than the rate from which they repriced. In addition, the loans advanced to repay the loans of other lenders were done so at rates lower than the average rate for long-term fixed-rate loans at the prior year-end. The decrease to the yields earned on long-term variable-rate loans and line of credit loans was due to the reduction of 175 basis points and 105 basis points, respectively, to the standard rates we charged for such loans on September 1, 2011. The reduction to interest income due to rates was offset slightly by placing a $420 million restructured loan on accrual status on October 1, 2011. The decrease in average loan balances for the year ended May 31, 2012 is primarily due to the decrease in power supply loans, which resulted from the repayment of bridge loans with proceeds of RUS long-term loans and the maturity of a $200 million RTFC loan during the year ended May 31, 2012.

While the total average loan balance for the year ended May 31, 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, large reductions to the average balance of the long-term variable-rate and line of credit loan portfolios were due to the repayments of bridge loans and

loan sales. 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 year ended May 31, 2012 represented 88 percent of the total average loan balance as compared with 84 percent for the prior year.

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 year ended May 31, 2012 decreased 98 basis points, compared with the prior year. 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 the refinanced 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 May 31, 2011. Thus, there was a reduction of 21 basis points in the weighted-average rate on our long-term fixed-rate loan portfolio during the year ended May 31, 2012, compared with the prior year.

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 year ended May 31, 2012. The combination of the lower interest rates and the lower average loan balances contributed to significant 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 had 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 had previously 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 resulted in an increase of $14 million to interest income and, therefore, a higher average rate on restructured loans for the year ended May 31, 2012, as compared with the prior year.

Our non-performing and restructured loans on non-accrual status affect interest income for both the current and prior year. 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)	2012	2011	2010
Electric	$ 7,918	$ 23,690	$ 23,822
Telecommunications	433	7,404	29,028
Total	$ 8,351	$ 31,094	$ 52,850

The decrease in interest foregone for electric loans in fiscal year 2012 was due to placing a $420 million restructured loan on accrual status on October 1, 2011 and the reduction to telecommunications loans was due to the significant lower balance of telecommunications loans on non-accrual status during fiscal year 2012. The reduction to interest forgone on telecommunications loans in fiscal year 2011 was due to the settlement of the ICC non-performing loan in fiscal year 2011. The larger amount of interest foregone for electric loans on non-accrual status for fiscal years 2011 and 2010 was mainly due to one large restructured loan that was on non-accrual status. In both years the amount of the interest forgone for that borrower 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

	Average volume			Interest expense			Average cost		
(dollar amounts in thousands)	2012	2011	2010	2012	2011	2010	2012	2011	2010
Commercial paper and bank bid	$ 3,011,409	$ 2,767,493	$ 2,099,916	$ (5,836)	$ (8,886)	$ (7,489)	(0.19)%	(0.32)%	(0.36)%

notes (1) (2)									
Medium-term notes (1)	3,078,905	3,877,036	4,632,884	(173,927)	(241,545)	(278,972)	(5.65)	(6.23)	(6.02)
Collateral trust bonds (1)	5,796,367	5,251,158	5,471,615	(314,642)	(306,332)	(320,059)	(5.43)	(5.83)	(5.85)
Subordinated deferrable debt (1)	180,962	211,428	301,914	(11,225)	(13,358)	(19,663)	(6.20)	(6.32)	(6.51)
Subordinated certificates (1)	1,718,055	1,783,091	1,750,077	(81,124)	(82,057)	(79,391)	(4.72)	(4.60)	(4.54)
Long-term notes payable (1)	4,518,181	4,654,860	4,656,934	(154,606)	(167,700)	(184,958)	(3.42)	(3.60)	(3.97)
Total	18,303,879	18,545,066	18,913,340	(741,360)	(819,878)	(890,532)	(4.05)	(4.42)	(4.71)
Debt issuance costs (3)	-	-	-	(9,044)	(10,358)	(10,927)	-	-	-
Fee expense (4)	-	-	-	(11,374)	(10,844)	(10,652)	-	-	-
Total	$ 18,303,879	$18,545,066	$18,913,340	$ (761,778)	$(841,080)	$(912,111)	(4.16)	(4.54)	(4.82)
Derivative cash settlements (5)	$ 10,123,071	$ 11,152,698	$ 11,397,281	$ (12,846)	$ (6,848)	$ (23,304)	(0.13)%	(0.06)%	(0.20)%
Adjusted interest expense (6)	18,303,879	18,545,066	18,913,340	(774,624)	(847,928)	(935,415)	(4.23)	(4.57)	(4.95)

(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

	2012 vs. 2011			2011 vs. 2010		
	Change due to (3)			Change due to (3)		
(dollar amounts in thousands)	Average volume (1)	Average rate (2)	Net change	Average volume (1)	Average rate (2)	Net change
(Increase) decrease in interest expense:						
Commercial paper and bank bid notes	$ (784)	$ 3,834	$ 3,050	$ (2,381)	$ 984	$ (1,397)
Medium-term notes	49,725	17,893	67,618	45,514	(8,087)	37,427
Collateral trust bonds	(31,805)	23,495	(8,310)	12,896	831	13,727
Subordinated deferrable debt	1,925	208	2,133	5,893	412	6,305
Subordinated certificates	2,993	(2,060)	933	(1,498)	(1,168)	(2,666)
Long-term notes payable	4,924	8,170	13,094	82	17,176	17,258
Total interest expense on debt	26,978	51,540	78,518	60,506	10,148	70,654
Debt issuance costs	-	1,314	1,314	-	569	569
Fee expense	-	(530)	(530)	-	(192)	(192)
Total interest expense	$ 26,978	$ 52,324	$ 79,302	$ 60,506	$ 10,525	$ 71,031
Derivative cash settlements (4)	$ 632	$ (6,630)	$ (5,998)	$ 500	$ 15,956	$ 16,456
Adjusted interest expense (5)	27,610	45,694	73,304	18,214	69,273	87,487

(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 year ended May 31, 2012, interest expense decreased by 9 percent compared with the prior year primarily due to the 38-basis-point reduction in the total cost of debt. The lower average cost of debt was due to the lower cost of issuing new debt in the capital markets, especially commercial paper and daily liquidity fund, and the refinancing of $1,500 million of higher cost medium-term notes with commercial paper and lower cost collateral trust bonds. This resulted in a higher utilization of commercial paper, our lowest cost debt instrument with an average cost of 19 basis points in fiscal year 2012, and a decrease of 13 basis points, or 41 percent, as compared with the prior year.

In August 2011 and October 2011 we redeemed early a total of $500 million of 7.25 percent medium-term notes with a maturity date of March 1, 2012. The redemption was funded with cash on hand and commercial paper due to the large amount of loan repayments during the first half of fiscal year 2012. In February 2012, we issued $800 million in

collateral trust bonds at a combined weighted average rate of 2.03 percent to replace the remaining $1,000 million of 7.25 percent medium-term notes that matured. In March 2012 and May 2012 we issued $269 million of long-term notes payable at a combined weighted average rate of 2.86 percent to fund the increased loan advance activity during the second half of fiscal year 2012. In addition, refinancing activity completed in fiscal year 2011 continues to impact our interest expense in fiscal year 2012.

While the early redemption of the $500 million of 7.25 percent medium-term notes resulted in a lower reported interest expense for the year, we did incur $16 million of expenses related to the prepayment premium and the write-off of unamortized issuance costs to complete the transactions. This expense of $16 million was reported as part of non-interest expense on the combined statement of operations. The interest expense savings as a result of the early redemptions is estimated to be approximately equal to the cost to complete the transactions. The primary benefit of the early redemptions was to reduce the amount of debt maturing on March 1, 2012. The reduction to interest expense for fiscal year 2012, excluding the $16 million as a result of the early redemption transactions, was $63 million.

The items described above contributed to the decrease in our interest expense and the change in the funding mix of debt outstanding during fiscal year 2012. Our utilization of commercial paper, bank bid notes and daily liquidity fund increased during fiscal year 2012 to 16 percent of total debt from 15 percent in the prior year, while the weighted average rate paid for our commercial paper funding decreased from 32 basis points to 19 basis points, a 41 percent reduction. Our utilization of collateral trust bond funding increased from 28 percent of total debt during fiscal year 2011 to 32 percent during fiscal year 2012, while our weighted average rate paid for our collateral trust bond funding decreased from 5.83 percent to 5.43 percent. Our utilization of medium-term note funding decreased from 21 percent of total debt during fiscal year 2011 to 17 percent during fiscal year 2012 due to the maturity of $1,500 million of 7.25 percent medium-term notes, and the weighted average rate paid on our medium-term note funding decreased from 6.23 percent to 5.65 percent.

During the year ended May 31, 2011, interest expense decreased 8 percent compared with the prior year primarily due to the 28-basis-point reduction in total cost of debt. The lower cost of debt was mostly the result of refinancing maturing term debt with a combination of commercial paper and term debt at lower interest rates. In November 2010, we issued collateral trust bonds at an average interest rate of 1.54 percent to refinance maturing collateral trust bonds with a fixed rate of 4.38 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.

The adjusted interest expense, which includes all derivative cash settlements, was $775 million for the year ended May 31, 2012, compared with $848 million and $935 million for the years ended May 31, 2011 and 2010, respectively. The decrease in adjusted interest expense during the year ended May 31, 2012 was due to the lower interest expense noted above. The adjusted interest expense, including expenses related to the prepayment premium and the write-off of unamortized issuance costs related to the early redemptions of medium-term notes, was $791 million at May 31, 2012. The adjusted interest expense was lower during the year ended May 31, 2011 as compared with the prior year period due to lower interest expense and a decrease in derivative cash settlements expense. Our adjusted interest expense fell from an average of $78 million per month for fiscal year 2010 to $71 million per month for fiscal year 2011 and $65 million per month for fiscal year 2012. 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 years ended May 31,					
	2012	2011	2010	2012	2011	2010
(dollar amounts in thousands)	Interest income (expense)			Average yield (cost)		
Total interest income	$ 960,961	$1,008,911	$1,043,635	5.06%	5.13%	5.14%
Total interest expense	(761,778)	(841,080)	(912,111)	(4.16)	(4.54)	(4.82)
Net interest income/Net yield	$ 199,183	$ 167,831	$ 131,524	0.90%	0.59%	0.32%
Derivative cash settlements	(12,846)	(6,848)	(23,304)	(0.13)	(0.06)	(0.20)
Adjusted net interest income/Adjusted net yield (1)	186,337	160,983	108,220	0.83	0.55	0.19

(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

	2012 vs. 2011			2011 vs. 2010		
	Change due to (3)			Change due to (3)		
(dollar amounts in thousands)	Average	Average rate (2)	Net change	Average	Average	Net change

	volume (1)			volume (1)	rate (2)	
Increase (decrease) in net interest income	$ 11,186	$ 20,166	$ 31,352	$ 66,509	$ (30,202)	$ 36,307
Increase in adjusted net interest income	11,818	13,536	25,354	24,217	28,546	52,763

(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 increased 19 percent for the year ended May 31, 2012 compared with the prior year while net interest income increased 28 percent for the year ended May 31, 2011 compared with the prior year. The increase to the net interest income for the years ended May 31, 2012 and 2011, as compared with the respective prior year, 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 during fiscal year 2012 was our refinancing of maturing term debt with lower cost debt. We maintained a higher average balance of collateral trust bonds and commercial paper, which have a lower weighted-average cost, in our overall funding mix and decreased the utilization of medium-term notes during the year ended May 31, 2012 compared with the prior years. Interest income for the year ended May 31, 2012 decreased 5 percent compared with the prior year 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 May 31, 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.

Adjusted net interest income increased 16 percent for the year ended May 31, 2012 compared with the prior year primarily due to the reduction to interest expense that exceeded the decrease in interest income, partially offset with higher cash settlements expense compared with the prior year. Adjusted net interest income increased 49 percent for the year ended May 31, 2011 compared with the prior year primarily due to the refinancing of maturing debt completed in the 2011. 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.

Recovery of Loan Losses

The recovery for loan losses during the year ended May 31, 2012 was $18 million compared with a loan loss recovery of $83 million during the prior year. The loan loss recovery of $18 million for the year ended May 31, 2012 was due to reductions in the allowance for loan losses held for the impaired loan portfolio of $11 million, and reductions in the allowance for loan losses held in the general portfolio of $7 million. The $11 million reduction to the loan loss allowance for impaired loans for the year ended May 31, 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 $15 million. The recovery for impaired loans during the year ended May 31, 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 and a $2 million increase to the reserve for one borrower as a result of a decrease in the fair value of collateral supporting the loan. The decrease of $7 million in the reserve for the general portfolio during the year ended May 31, 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 $83 million for the year ended May 31, 2011 was driven by the higher fair value of collateral securing impaired loans, principal repayments on impaired loans, improvement in the borrowers' average internal risk rating, as well as updated credit default information and a lower weighted average maturity for the loans in the general portfolio.

Non-interest Income

Non-interest income decreased by $264 million for the year ended May 31, 2012 compared with the prior year primarily due to increases in derivative losses of $206 million and an increase in the loss on foreclosed asset operations of $52 million. The increase to the loss on foreclosed assets operations was primarily due to impairment charges for goodwill and other assets related to CAH's telecommunications and cable television operations totaling $45 million recorded during the third quarter of fiscal year 2012. During the third quarter of fiscal year 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, and 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 third quarter of fiscal year 2012. Non-interest income decreased by $40 million for the year ended May 31, 2011 compared with the prior year primarily due to $23 million of settlement income recognized during the year ended May 31, 2010. The settlement income was a one-time gain, net of legal and other related expenses from CoBank, ACB. On February 25, 2010, CoBank, ACB, agreed to a settlement related to our discovery that, for a period of years, CoBank, ACB, employees improperly accessed confidential and proprietary information from our password-protected member website.

The derivative losses line item includes income and losses recorded for our interest rate swaps as summarized below for the years ended May 31:

(dollar amounts in thousands)	2012	2011	2010
Derivative cash settlements	$ (12,846)	$ (6,848)	$ (23,304)

Derivative forward value	(223,774)	(23,388)	2,696
Derivative losses	$ (236,620)	$ (30,236)	$ (20,608)

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 during the years ended May 31:

	2012			2011		
(dollar amounts in thousands)	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	$ 5,438,576	3.93%	0.39%	$ 5,704,683	4.23%	0.33%
Pay variable-receive fixed	4,684,495	1.31	5.18	5,448,015	1.22	5.23
Total	$ 10,123,071	2.72	2.61	$11,152,698	2.76	2.73

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During the year ended May 31, 2012, the net weighted-average rate we paid on our interest rate swap agreements was 0.11 percent, whereas we paid a net weighted-average rate of 0.03 percent during the prior year. The primary reason for the increase in the weighted-average outflow was the reduction in the average notional amount for our pay variable-receive fixed interest rate swaps, due to the $1,000 million of pay variable-receive fixed interest rate swaps that matured during the fourth quarter of fiscal year 2012.

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 year ended May 31, 2012 decreased by $200 million compared with the prior year. For the year ended May 31, 2012, the derivative forward value losses of $224 million were the result of decreases to the estimated yield curve of 85 basis points for our swaps based on market expectations of interest rates, which caused a decrease in the fair value of pay fixed-receive variable interest rate swaps. During the year ended May 31, 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 54 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 year ended May 31, 2012, the fair value for pay variable-receive fixed swaps also declined in spite of the 85 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 increased $7 million for the year ended May 31, 2012 compared with the prior year 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 $3 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 year ended May 31, 2011. The $3 million decrease in general and administrative expenses during the year ended May 31, 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. Non-interest expense increased $9 million for the year ended May 31, 2011 compared with the prior year primarily due to a smaller recovery of guarantee liability as a result of a smaller decrease in guarantees outstanding during the year ended May 31, 2011 compared with the prior year and early debt redemption costs.

Net (Loss) Income
The changes in the items described above resulted in net loss of $149 million for the year ended May 31, 2012 compared with net income of $151 million and $111 million for the years ended May 31, 2011 and 2010, respectively. The adjusted net income, which excludes the effect of the derivative forward value, was $75 million, $175 million and $108 million for the years ended May 31, 2012, 2011 and 2010, respectively. Based on the adjusted net income, adjusted TIER was 1.10, 1.21, and 1.12 for the years ended May 31, 2012, 2011, and 2010, respectively. 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 year ended May 31, 2012 represents $0.2 million of net income and $4.3 million of net loss for RTFC and NCSC, respectively, compared with net loss of $0.4 million and net income of $2.2 million for RTFC and NCSC, respectively, for the prior year. Noncontrolling interest for the year ended May 31, 2010 represents an RTFC net loss of $0.6 million and NCSC net income of $0.8 million. 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.

(dollar amounts in thousands)	2012	2011	2010
Net (loss) income prior to cumulative effect of change in accounting principle	$ (148,797)	$ 151,215	$ 110,547
Add: fixed charges	761,849	841,288	912,227
Less: interest capitalized	(71)	(208)	(116)
Earnings available for fixed charges	$ 612,981	$ 992,295	$1,022,658
Total fixed charges:			
Interest on all debt (including amortization of discount and issuance costs)	$ 761,778	$ 841,080	$ 912,111
Interest capitalized	71	208	116
Total fixed charges	$ 761,849	$ 841,288	$ 912,227
Ratio of earnings to fixed charges (1)	-	1.18	1.12

(1) For the year ended May 31, 2012, we reported a net loss of $149 million; therefore, the TIER for this period results 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 at May 31:

(dollar amounts in millions)	2012		2011		2010		2009		2008	
Loans by type (1):	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Long-term loans:										
Long-term fixed-rate loans	$ 16,743	89%	$ 16,405	85%	$ 15,413	80%	$ 14,602	73%	$ 15,205	80%
Long-term variable-rate loans	765	4	1,278	7	2,089	11	3,244	16	1,882	10
Loans guaranteed by RUS	219	1	227	1	237	1	244	1	250	1
Total long-term loans	17,727	94	17,910	93	17,739	92	18,090	90	17,337	91
Line of credit loans	1,185	6	1,415	7	1,599	8	2,098	10	1,690	9
Total loans	$ 18,912	100%	$ 19,325	100%	$ 19,338	100%	$ 20,188	100%	$ 19,027	100%

Loans by member class (1):

CFC:										
Distribution	$ 14,075	74%	$ 13,760	71%	$ 13,459	70%	$ 13,730	68%	$ 13,438	71%
Power supply	3,597	19	4,092	21	3,770	19	4,268	21	3,339	17
Statewide and associate	74	1	90	1	86	-	93	1	109	1
CFC total	17,746	94	17,942	93	17,315	89	18,091	90	16,886	89
RTFC	572	3	859	4	1,672	9	1,680	8	1,727	9
NCSC	594	3	524	3	351	2	417	2	414	2
Total	$ 18,912	100%	$ 19,325	100%	$ 19,338	100%	$ 20,188	100%	$ 19,027	100%

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

The balance of loans outstanding decreased by $413 million during the year ended May 31, 2012 mainly due to the $495 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 that were partially offset by new advances to distribution borrowers. There was also the maturity of a $200 million loan to an RTFC borrower during the year ended May 31, 2012, which was the primary contributor to the $287 million decrease in RTFC loans outstanding.

During the year ended May 31, 2012, $1,683 million of CFC long-term fixed-rate loans were scheduled to reprice. Of this total, $1,338 million selected a new long-term fixed rate; $220 million selected the long-term variable rate; $52 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 $73 million were prepaid in full.

The following table summarizes loans and guarantees outstanding by member class at May 31:

(dollar amounts in thousands)	2012 Amount	% of Total	2011 Amount	% of Total	Increase/ (decrease)
CFC:					
Distribution	$ 14,415,856	72%	$ 13,977,327	68%	$ 438,529
Power supply	4,451,264	22	4,909,908	24	(458,644)
Statewide and associate	80,808	-	109,768	1	(28,960)
CFC total	18,947,928	94	18,997,003	93	(49,075)
RTFC	572,592	3	859,943	4	(287,351)
NCSC	640,552	3	572,718	3	67,834
Total loans and guarantees	$ 20,161,072	100%	$ 20,429,664	100%	$ (268,592)

Credit Concentration

CFC, RTFC and NCSC each have policies that limit the amount of credit that can be extended to individual borrowers or a controlled group of borrowers. The credit limitation policies cap the total exposure and unsecured exposure to the borrower based on an assessment of the borrower's risk profile and our internal risk rating system. As a member-owned cooperative lender, we balance the needs of our members and the risk associated with concentrations of credit exposure. Each board of directors must approve new credit requests from borrowers with total exposure or unsecured exposure in excess of the limits in the policies. Management may use syndicated credit arrangements, loan participations and loan sales to manage credit concentrations.

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 May 31, 2012 and 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 May 31, 2012 and 2011, the total exposure outstanding to any one borrower or controlled group did not exceed 2.4 percent of total loans and guarantees outstanding. At May 31, 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 at May 31:

(dollar amounts in thousands)	2012 Amount	% of Total	2011 Amount	% of Total	Increase/ (decrease)
Total by exposure type:					
Loans	$ 2,852,364	14%	$ 3,206,808	16%	$ (354,444)
Guarantees	481,706	3	302,771	1	178,935
Total credit exposure to 10 largest borrowers	$ 3,334,070	17 %	$ 3,509,579	17 %	$ (175,509)
Total by company:					
CFC	$ 3,314,070	17%	$ 3,488,329	17%	$ (174,259)
NCSC	20,000	-	21,250	-	(1,250)
Total credit exposure to 10 largest borrowers	$ 3,334,070	17 %	$ 3,509,579	17 %	$ (175,509)

Security Provisions

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 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. Guarantee reimbursement obligations are typically secured on parity with other secured creditors by substantially all assets and revenue of the borrower or by the underlying financed asset. In addition to the collateral pledged to secure our loans, borrowers are also required to set rates charged to customers to achieve certain financial ratios.

The following table summarizes our unsecured credit exposure as a percentage of total exposure presented by type of exposure and by company at May 31:

	2012		2011		Increase/
(dollar amounts in thousands)	Amount	% of Total	Amount	% of Total	(decrease)
Total by exposure type:					
Loans	$ 1,657,543	8%	$ 2,200,140	11%	$ (542,597)
Guarantees	385,165	2	281,431	1	103,734
Total unsecured credit exposure	$ 2,042,708	10%	$ 2,481,571	12%	$ (438,863)
Total by company:					
CFC	$ 1,811,830	9%	$ 2,041,440	10%	$ (229,610)
RTFC	23,507	-	231,923	1	(208,416)
NCSC	207,371	1	208,208	1	(837)
Total unsecured credit exposure	$ 2,042,708	10%	$ 2,481,571	12%	$ (438,863)

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 at May 31:

(dollar amounts in thousands)	2012	2011
Total loans to members	$ 18,911,742	$ 19,324,676
Less: Total secured debt or debt requiring collateral on deposit	(10,927,587)	(10,111,094)
Excess collateral pledged or on deposit (1)	(1,870,675)	(1,668,457)
Unencumbered loans	$ 6,113,480	$ 7,545,125
Unencumbered loans as a percentage of total loans	32%	39%

(1) Excludes cash collateral pledged to secure debt. Unless and until there is an event of default, we can withdraw excess collateral as long as there is 100 percent coverage of the secured debt. If there is an event of default under most of our indentures, we can only withdraw this excess collateral if we substitute cash of equal value.

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 at May 31:

(dollar amounts in thousands)	2012	2011	2010	2009	2008
Non-performing loans (1)	$ 41,213	$ 31,344	$ 560,527	$ 523,758	$ 506,864
Percent of loans outstanding	0.22%	0.16%	2.90%	2.59%	2.67%
Percent of loans and guarantees outstanding	0.20	0.15	2.73	2.44	2.52
Restructured loans	$ 455,689	$ 474,381	$ 508,044	$ 537,587	$ 577,111
Percent of loans outstanding	2.41%	2.45%	2.63%	2.66%	3.03%
Percent of loans and guarantees outstanding	2.26	2.32	2.48	2.50	2.88
Total non-performing and restructured loans	$ 496,902	$ 505,725	$ 1,068,571	$1,061,345	$1,083,975

Percent of loans outstanding	2.63%	2.61%	5.53%	5.25%	5.70%
Percent of loans and guarantees outstanding	2.46	2.47	5.21	4.94	5.40
Total non-accrual loans	$ 41,213	$ 465,312	$ 1,022,924	$1,014,585	$1,026,121
Percent of loans outstanding	0.22%	2.41%	5.29%	5.03%	5.39%
Percent of loans and guarantees outstanding	0.20	2.28	4.99	4.73	5.11

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

A borrower is classified as non-performing when any one of the following criteria is met:

- principal or interest payments on any loan to the borrower are past due 90 days or more;
- as a result of court proceedings, repayment on the original terms is not anticipated; or
- for some other reason, management does not expect the timely repayment of principal and interest.

Once a borrower is classified as non-performing, we typically place the loan on non-accrual status and reverse all accrued and unpaid interest back to the date of the last payment.

At May 31, 2012 and 2011, non-performing loans included $41 million, or 0.2 percent, of loans outstanding and $31 million, or 0.2 percent, of loans outstanding, respectively. Two borrowers in this group are currently in bankruptcy. In one of the bankruptcy cases, the borrower has until September 14, 2012 to file a plan of reorganization. The other bankruptcy case does

not yet have a scheduled date for the borrower to file a plan of reorganization. Two other borrowers in this group are currently seeking buyers for their systems, as it is not anticipated that they will have sufficient cash flow to repay their loans as scheduled through maturity. It is currently anticipated that even with the sales of the businesses, there will not be sufficient funds to repay the full respective amount owed. We have approval rights with respect to the sale of either or both of these companies.

At May 31, 2012 and 2011, we had restructured loans totaling $456 million, or 2.4 percent, of loans outstanding and $474 million, or 2.5 percent, of loans outstanding, respectively, all of which were performing according to their restructured terms. Approximately $16 million of interest income was accrued on restructured loans during the year ended May 31, 2012 compared with $3 million of interest income in the prior year. One of the restructured loans totaling $40 million at both May 31, 2012 and 2011 has been on accrual status since the time of restructuring. The other restructured loan totaling $416 million and $434 million at May 31, 2012 and 2011, respectively, was on non-accrual status through September 30, 2011, with all amounts collected being applied against the principal balance. On October 1, 2011, the principal balance of the loan was reduced below the level of a buyout option and as such we placed the loan on accrual status at that time at a rate based on the effective rate returned by the future scheduled cash flows.

Based on our analysis, we believe we have an adequate loan loss allowance for our exposure related to non-performing and restructured loans at May 31, 2012.

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. The allowance for loan losses is determined based upon evaluation of the loan portfolio, past loss experience, specific problem loans, economic conditions and other pertinent factors that, in management's judgment, could affect the risk of loss in the loan portfolio. We review and adjust the allowance quarterly to cover estimated probable losses in the portfolio. All loans are written off in the period that it becomes evident that collectability is highly unlikely; however, our efforts to recover all charged-off amounts may continue. Management believes the allowance for loan losses is adequate to cover estimated probable portfolio losses.

Under a guarantee agreement, CFC reimburses RTFC and NCSC for loan losses; therefore, RTFC and NCSC do not maintain separate loan loss reserves. Activity in the allowance for loan losses is summarized below including a disaggregation by company of the allowance for loan losses held at CFC:

	As of and for the years ended May 31,				
(dollar amounts in thousands)	2012	2011	2010	2009	2008
Beginning balance	$ 161,177	$ 592,764	$ 622,960	$ 514,906	$ 561,663
(Recovery of) provision for loan losses	(18,108)	(83,010)	(30,415)	113,699	(30,262)
Net recovery (charge-off)	257	(348,577)	219	(5,645)	(16,495)
Ending balance	$ 143,326	$ 161,177	$ 592,764	$ 622,960	$ 514,906
`					
Loan loss allowance by segment:					
CFC (1)	$ 126,941	$ 143,706	$ 177,655	$ 224,688	$ 247,443
RTFC (1)	8,562	8,389	406,214	378,194	244,567
NCSC (1)	7,823	9,082	8,895	20,078	22,896
Total	$ 143,326	$ 161,177	$ 592,764	$ 622,960	$ 514,906
As a percentage of total loans outstanding	0.76 %	0.84%	3.07%	3.09%	2.71%
	347.77	514.22	105.75	118.94	101.59

As a percentage of total non-performing loans outstanding					
As a percentage of total restructured loans outstanding	31.45	33.98	116.68	115.88	89.22
As a percentage of total loans on non-accrual	347.77	34.64	57.95	61.40	50.18

(1) The allowance for loan losses recorded for RTFC and NCSC is held at CFC with the exception of the NCSC loan loss allowance of less than $1 million for the years ended May 31, 2010, 2009 and 2008, required to cover the exposure for consumer loans. The balance of NCSC's consumer loans was reduced to zero at May 31, 2012 and 2011.

Our loan loss allowance decreased by $18 million from May 31, 2011 to May 31, 2012 due to reductions in the allowance for loan losses held for the impaired loan portfolio of $11 million and the $7 million decrease in the allowance for loan losses held for the general portfolio. See 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 May 31, 2012 and 2011, there was a total specific loan loss allowance balance of $25 million and $37 million, respectively, related to impaired loans totaling $497 million and $506 million, respectively.

Liabilities and Equity
Outstanding Debt
The following table breaks out our debt outstanding and the weighted average interest rates by type of debt at May 31:

	2012		2011		2010	
(dollar amounts in thousands)	Amounts Outstanding	Weighted-Average Interest Rate	Amounts Outstanding	Weighted-Average Interest Rate	Amounts Outstanding	Weighted-Average Interest Rate
Commercial paper sold through dealers, net of discounts	$ 1,404,901	0.18%	$ 1,471,715	0.26%	$ 840,082	0.32%
Commercial paper sold directly to members, at par	997,778	0.18	1,189,770	0.22	999,449	0.31
Commercial paper sold directly to non-members, at par	70,479	0.18	55,160	0.21	52,989	0.32
Daily liquidity fund	478,406	0.10	308,725	0.15	371,710	0.24
Bank bid notes	295,000	0.51	295,000	0.60	30,000	0.60
Collateral trust bonds	6,307,564	5.11	5,513,235	5.56	5,469,245	5.76
Notes payable	4,650,877	3.27	4,633,854	3.45	4,666,518	3.93
Medium-term notes	2,423,686	4.56	3,656,274	5.96	4,230,865	6.00
Subordinated deferrable debt	186,440	6.02	186,440	6.02	311,440	6.31
Membership certificates	646,279	4.90	646,161	4.90	643,211	4.90
Loan and guarantee certificates	694,825	3.09	769,241	2.91	769,654	2.79
Member capital securities	398,350	7.50	398,250	7.50	397,850	7.50
Total debt outstanding	$ 18,554,585	3.67	$ 19,123,825	4.12	$ 18,783,013	4.59
Percentage of fixed-rate debt (1)	86%		79%		81%	
Percentage of variable-rate debt (2)	14		21		19	
Percentage of long-term debt	83%		83%		88%	
Percentage of short-term debt	17		17		12	

(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.

Total debt outstanding decreased by $569 million at May 31, 2012 as compared with May 31, 2011, primarily due to a $413 million decrease to loans outstanding and a decrease of $102 million to cash. There was a net reduction of $1,233 million to our medium-term notes outstanding, primarily due to the early redemption of $500 million of 7.25 percent medium-term notes during the first half of the year and the maturity of the remaining $1,000 million of the 7.25 percent medium-term notes on March 1, 2012. We refinanced this maturing debt primarily through the issuance of $800 million of collateral trust bonds.

Total commercial paper, daily liquidity fund and bank bid notes outstanding represented 17 percent of total debt at both May 31, 2012 and 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.

The following table provides additional information on our outstanding debt instruments at May 31, 2012.

Debt Instrument	Maturity Range	Rate Options	Market	Security
Daily liquidity fund	Demand note	Rate may change daily	Members	Unsecured
Bank bid notes	Up to 3 months	Fixed rate (1)	Bank institutions	Unsecured
Commercial paper	1 to 270 days	Fixed rate (1)	Public capital markets and members	Unsecured
Collateral trust bonds	Up to 30 years	Fixed or variable rate	Public capital markets	Secured (2)
Medium-term notes	Range from 9 months to 30 years	Fixed or variable rate	Public capital markets and members	Unsecured
Notes payable to the Federal Financing Bank	Range from 3 months to 20 years	Fixed	Government	Unsecured (3)
Notes payable to Federal Agricultural Mortgage Corporation	Up to 7 years	Fixed or variable rate	Private placement	Secured (4)
Other notes payable	Up to 30 years	Fixed or variable rate	Private placement	Varies (5)
Subordinated deferrable debt	Up to 39 years (6)	Fixed or variable rate (6)	Public capital markets	Unsecured (7)
Subordinated certificates	Up to 100 years (8)	Varies	Members	Unsecured (9)

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(1) The rate on bank bid notes and commercial paper notes does not change once the note has been issued. However, the rates on new bank bid notes and commercial paper notes change daily, and bank bid notes and commercial paper notes generally have maturities of less than 90 days. Therefore, we consider bank bid notes and commercial paper notes to be variable-rate debt in our financial analysis.
(2) Secured by the pledge of permitted investments and eligible mortgage notes from distribution system borrowers in an amount at least equal to the outstanding principal amount of collateral trust bonds.
(3) Represents notes payable issued to the Federal Financing Bank with a guarantee of repayment by RUS under the Guaranteed Underwriter program of the USDA, which supports the Rural Economic Development Loan and Grant program. We are required to maintain collateral on deposit equal to at least 100 percent of the outstanding balance of debt.
(4) We are required to pledge eligible mortgage notes from distribution and power supply system borrowers in an amount at least equal to the outstanding principal amount under note purchase agreements with the Federal Agricultural Mortgage Corporation.
(5) At May 31, 2012, other notes payable includes unsecured and secured Clean Renewable Energy Bonds. We are required to pledge eligible mortgage notes from distribution and power supply system borrowers in an amount at least equal to the outstanding principal amount under the Clean Renewable Energy Bonds Series 2009A note purchase agreement. The remaining other notes payable relate to unsecured notes payable issued by NCSC.
(6) We have the right at any time and from time to time during the term of the subordinated deferrable debt to suspend interest payments for a period not exceeding 20 consecutive quarters. We have the right to call the subordinated deferrable debt any time after five years, at par. To date, we have not exercised our option to suspend interest payments.
(7) Subordinate and junior in right of payment to senior debt and the debt obligations we guarantee, but senior to subordinated certificates.
(8) Membership subordinated certificates generally mature 100 years from issuance. Loan and guarantee subordinated certificates have the same maturity as the related long-term loan. Some certificates may also amortize annually based on the outstanding loan balance. Member capital securities mature 35 years from issuance. Member capital securities are callable at par by CFC starting five years from the date of issuance and anytime thereafter.
(9) Subordinate and junior in right of payment to senior and subordinated debt and debt obligations we guarantee.

The following is a summary of short-term debt outstanding and the weighted-average effective interest rates at May 31:

(dollar amounts in thousands)	2012		2011		2010	
	Debt Outstanding	Weighted-Average Effective Interest Rate	Debt Outstanding	Weighted-Average Effective Interest Rate	Debt Outstanding	Weighted-Average Effective Interest Rate
Short-term debt:						
Total commercial paper	$ 2,473,158	0.19%	$ 2,716,645	0.25%	$ 1,892,520	0.32%
Daily liquidity fund sold directly to members	478,406	0.10	308,725	0.15	371,710	0.24
Bank bid notes	295,000	0.52	295,000	0.60	30,000	0.61
Subtotal short-term debt	3,246,564	0.20	3,320,370	0.27	2,294,230	0.31
Long-term debt maturing within one year	1,246,870	2.13	2,522,554	5.20	2,312,131	3.38
Total short-term debt	$ 4,493,434	0.74	$ 5,842,924	2.40	$ 4,606,361	1.85

Other information about short-term debt at May 31 is as follows:

(dollar amounts in thousands)	2012	2011	2010
Weighted-average maturity outstanding at year-end:			
Commercial paper	21 days	29 days	27 days
Daily liquidity fund sold directly to members	1 day	1 day	1 day
Bank bid notes	6 days	33 days	12 days
Subtotal short-term debt	17 days	27 days	23 days
Long-term debt maturing within one year	158 days	249 days	137 days
Total	56 days	123 days	80 days
Average amount outstanding during the year:			
Commercial paper	$ 2,492,791	$2,698,653	$ 1,822,745
Daily liquidity fund sold directly to members	413,525	343,311	353,688
Bank bid notes	295,000	208,333	102,083
Subtotal short-term debt	3,201,316	3,250,297	2,278,516
Long-term debt maturing within one year	2,168,220	1,550,369	2,164,554
Total	$ 5,369,536	$4,800,666	$ 4,443,070
Maximum amount outstanding at any month-end during the year:			
Commercial paper	$ 2,746,189	$3,424,449	$ 2,634,838
Daily liquidity fund sold directly to members	478,406	440,806	537,705
Bank bid notes	295,000	295,000	225,000
Subtotal short-term debt	3,431,617	3,975,621	3,180,865
Long-term debt maturing within one year	2,697,751	2,522,554	2,659,650

Equity

Equity includes the following components at May 31:

(dollar amounts in thousands)	2012	2011	Increase/ (Decrease)
Membership fees	$ 995	$ 994	$ 1
Education fund	1,418	1,437	(19)
Members' capital reserve	272,126	272,126	-
Allocated net income	546,366	521,897	24,469
Unallocated net loss (1)	(6,222)	(6,213)	(9)
Total members' equity	814,683	790,241	24,442
Prior years cumulative derivative forward value and foreign currency adjustments	(124,476)	(100,778)	(23,698)
Year-to-date derivative forward value loss (2)	(216,243)	(23,698)	(192,545)
Total CFC retained equity	473,964	665,765	(191,801)
Accumulated other comprehensive income	9,199	9,758	(559)
Total CFC equity	483,163	675,523	(192,360)
Noncontrolling interest	7,592	11,786	(4,194)
Total equity	$ 490,755	$ 687,309	$ (196,554)

(1) Excludes derivative forward value.

(2) Represents the derivative forward value loss recorded by CFC for the year-to-date period.

At May 31, 2012, total equity decreased by $197 million from May 31, 2011 largely due to a net loss of $149 million for the year ended May 31, 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.

In July 2012, the CFC Board of Directors authorized the allocation of the fiscal year 2012 net earnings as follows: $1 million to the cooperative educational fund and $71 million to members in the form of patronage capital. In July 2012, the CFC Board of Directors authorized the retirement of allocated net earnings totaling $35 million, representing 50 percent of the fiscal year 2012 allocation. It is anticipated that this amount will be returned to members in cash in September 2012. 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.

Noncontrolling interest represents 100 percent of RTFC and NCSC equity as the members of RTFC and NCSC own or control 100 percent of the interest in their respective companies.

In accordance with District of Columbia cooperative law, its bylaws and board policies, RTFC allocates its net earnings to its patrons, a cooperative educational fund and a general reserve, if necessary. RTFC's bylaws require that it allocate at least 1 percent of net earnings to a cooperative educational fund. An allocation to the general reserve is made, if necessary, to maintain the balance of the general reserve at 50 percent of the membership fees collected. The

remainder is allocated to borrowers in proportion to their patronage. RTFC retires at least 20 percent of the allocation for that year to members in cash prior to filing the applicable tax return. Any additional amounts are retired as determined by the RTFC Board of Directors with due regard for RTFC's financial condition. In January 2012, RTFC retired $1 million to its members representing 20 percent of allocated net earnings for fiscal year 2011. In accordance with District of Columbia cooperative law and its bylaws and board policies, NCSC allocates its net earnings to a cooperative educational fund, to a general reserve, if necessary, and to board-approved reserves. NCSC's bylaws require the allocation to the cooperative educational fund to be at least 0.25 percent of its net earnings. An allocation to the general reserve is made, if necessary, to maintain the balance of the general reserve at 50 percent of the membership fees collected. The NCSC Board of Directors has the authority to determine if and when net earnings will be retired to members.

Contractual Obligations

The following table summarizes our long-term contractual obligations at May 31, 2012 and the scheduled reductions by fiscal year and thereafter:

(dollar amounts in millions)	2013	2014	2015	2016	2017	Thereafter	Total
Contractual Obligations (1)							
Long-term debt due in less than one year	$ 1,247	$ -	$ -	$ -	$ -	$ -	$ 1,247
Long-term debt	-	2,636	844	987	595	7,090	12,152
Subordinated deferrable debt	-	-	-	-	-	186	186
Members' subordinated certificates (2)	-	12	28	22	12	1,498	1,572
Contractual interest on long-term debt (3)	659	587	534	513	493	5,837	8,623
Total contractual obligations	$ 1,906	$ 3,235	$ 1,406	$ 1,522	$ 1,100	$ 14,611	$ 23,780

(1) The table does not include contractual obligations of the entities that are included in our foreclosed assets.
(2) Excludes loan subordinated certificates totaling $151 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 2012, amortization represented 14 percent of amortizing loan subordinated certificates outstanding.
(3) Represents the interest obligation on our debt based on terms and conditions at May 31, 2012.

Off-Balance Sheet Obligations

Guarantees

The following table breaks out our guarantees outstanding by type of guarantee and by company at May 31:

(dollar amounts in thousands)	2012	2011	Increase/ (decrease)
Total by guarantee type:			
Long-term tax-exempt bonds	$ 573,110	$ 599,935	$ (26,825)
Indemnifications of tax benefit transfers	49,771	59,895	(10,124)
Letters of credit	504,920	327,201	177,719
Other guarantees	121,529	117,957	3,572
Total	$ 1,249,330	$ 1,104,988	$ 144,342
Total by company:			
CFC	$ 1,202,031	$ 1,055,524	$ 146,507
RTFC	1,026	821	205
NCSC	46,273	48,643	(2,370)
Total	$ 1,249,330	$ 1,104,988	$ 144,342

In addition to the letters of credit listed in the table, under master letters of credit facilities in place at May 31, 2012, we may be required to issue up to an additional $787 million in letters of credit to third parties for the benefit of our members. Of this amount, $615 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 3, Loans and Commitments. Master letters of credit facilities subject to material adverse change clauses at the time of issuance totaled $477 million at May 31, 2012. Prior to issuing a letter of credit,

we would confirm that there has been no material adverse change in the business or 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 $310 million may be advanced as long as the borrower is in compliance with the terms and conditions of the facility.

We guarantee certain contractual obligations of our members so that they may obtain various forms of financing. We use the same credit policies and monitoring procedures in providing guarantees as we do for loans and commitments. If a member system defaults on its obligation to pay debt service, then we are obligated to pay any required amounts under our guarantees. Meeting our guarantee obligations satisfies the underlying obligation of our member systems and prevents the exercise of remedies by the guarantee beneficiary based upon a payment default by a member system. In general, the member system is required to repay, on demand, any amount advanced by us with interest, pursuant to the documents evidencing the member system’s reimbursement obligation. At May 31, 2012 and 2011, 69 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 year ended May 31, 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 May 31, 2012 and 2011, we recorded a guarantee liability totaling $29 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 May 31, 2012, and the related maturities by fiscal year and thereafter as follows:

		Maturities of guaranteed obligations					
(dollar amounts in thousands)	Outstanding balance	2013	2014	2015	2016	2017	Thereafter
Guarantees (1)	$ 1,249,330	$ 278,181	$ 56,440	$ 314,898	$ 23,069	$ 92,609	$ 484,133

(1) At May 31, 2012, we are the guarantor and liquidity provider for $498 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 May 31, 2012 and 2011, we had the following amount of unadvanced commitments on loans to our borrowers.

(dollar amounts in thousands)	2012	% of Total	2011	% of Total
Long-term	$ 5,437,881	38%	$ 5,461,484	39%
Line of credit	8,691,543	62	8,609,191	61
Total	$ 14,129,424	100%	$14,070,675	100%

A total of $1,303 million and $999 million of unadvanced commitments at May 31, 2012 and 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 May 31, 2012 and 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 or 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 five years from the date of the loan agreement.

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 May 31, 2012, and the related maturities by fiscal year as follows:

(dollar amounts in thousands)	Available balance	Notional maturities of committed lines of credit				
		2013	2014	2015	2016	2017
Committed lines of credit	$1,302,909	$ 127,135	$ 326,634	$ 91,800	$ 248,500	$ 508,840

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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 May 31, 2012 was 42.20 -to-1, an increase from 30.52-to-1 at May 31, 2011. The increase in the leverage ratio is due to the increase of $144 million in guarantees and the decrease of $197 million in total equity partially offset by the decrease of $414 million in total liabilities as discussed under the Liabilities and Equity section of Financial Condition and under Off-Balance Sheet Obligations.

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 May 31, 2012 and 2011, the adjusted leverage ratio was 6.46 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 decrease to the adjusted leverage ratio was due to increases of $144 million to guarantees and the decrease of $46 million in adjusted equity, offset by the decrease of $509 million in adjusted liabilities as discussed under the Liabilities and Equity section of Financial Condition and under Off-Balance Sheet Obligations.

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 May 31, 2012 was 39.65 -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 decrease of $197 million in total equity, partially offset by the decrease of $414 million in total liabilities 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 May 31, 2012 and 2011, the adjusted debt-to-equity ratio was 6.01 -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 decrease in the adjusted debt-to-equity ratio is due to the decrease of $46 million in adjusted equity, offset by the decrease of $509 million in adjusted liabilities.

Liquidity and Capital Resources

The following section discusses our expected sources and uses of liquidity. At May 31, 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 November 30, 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 May 31, 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.

	Projected uses of liquidity				Projected sources of liquidity					
						Debt Issuance				
(dollar amounts in millions)	Long-term debt maturities	Debt repayment- commercial paper	Long-term loan advances	Total uses of liquidity	Long-term loan amortization & prepayment	Commercial paper	Other long-term debt	Medium term notes	Total sources of liquidity	Cu e s u li
4Q12										$
1Q13	$ 315	$ -	$ 438	$ 753	$ 329	$ -	$ 320	$ 120	$ 769	
2Q13	421	-	1,058	1,479	661	-	700	120	1,481	
3Q13	334	-	144	478	373	-	-	120	493	
4Q13	177	200	110	487	362	-	-	120	482	
1Q14	956	-	316	1,272	319	200	620	120	1,259	
2Q14	357	-	216	573	248	-	200	120	568	
Totals	$ 2,560	$ 200	$ 2,282	$ 5,042	$ 2,292	$ 200	$ 1,840	$ 720	$ 5,052	

The chart on page 52 represents our best estimate of the funding requirements and how we expect to manage such funding requirements through November 30, 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 11-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 $1,700 million and represented 9 percent of total debt outstanding at May 31, 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 fiscal year 2013.

Private Debt Issuance

We have access to liquidity from private debt issuances through a note purchase agreement with the Federal Agricultural Mortgage Corporation. At May 31, 2012 and 2011, we had secured notes payable of $1,165 million and $1,411 million, respectively, 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 May 31, 2012, we had up to $2,735 million available under this agreement, subject to market conditions for debt issued by the Federal Agricultural Mortgage Corporation.

At May 31, 2012 and 2011, we had $3,419 million and $3,150 million, respectively, 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 USDA, which supports the Rural Economic Development Loan and Grant program and provides guarantees to the Federal Financing Bank. In the aggregate at May 31, 2012, we had up to $580 million available under committed loan facilities from the Federal Financing Bank as part of this program. At May 31, 2012 and 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. During the year ended May 31, 2012, we borrowed $269 million under our $499 million committed loan facility at a weighted average interest rate of 2.86 percent with a repricing period ranging from 10 to 15 years and a final maturity of 20 years. Subsequent to May 31, 2012, we borrowed $255 million under our committed loan facilities with the Federal Financing Bank.

Member Loan Repayments

We expect long-term loan repayments from scheduled loan amortization and prepayments to be $1,725 million over the next 12 months. Scheduled repayments include the principal amortization of long-term loans in each of the five fiscal years following May 31, 2012 and thereafter as follows:

(dollar amounts in thousands)	Amortization
2013 (1)	$ 1,025,831
2014	960,515
2015	931,621
2016	968,604
2017	865,015
Thereafter	12,975,227
Total	$ 17,726,813

(1) Represents scheduled amortization based on current rates without consideration for loans that reprice.

Member Loan Interest Payments

During the year ended May 31, 2012, interest income on the loan portfolio was $950 million, representing an average rate of 5.09 percent compared with 5.15 percent and 5.22 percent for the years ended May 31, 2011 and 2010. For the past three fiscal years, interest income on the loan portfolio has averaged $993 million. At May 31, 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 May 31, 2012 and 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 May 31, 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 at May 31:

	Total available		Letters of credit outstanding			
(dollar amounts in thousands)	2012	2011	2012	2011	Original maturity	Facility fee per year (1)
Three-year agreement	$ 1,125,000	$ 1,125,000	$ -	$ -	March 21, 2014	15 basis points
Four-year agreement	883,875	-	1,000	-	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	$ 2,843,750	$ 3,544,526	$ 1,000	$ 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 at May 31:

	2012		2011		Increase/
(dollar amounts in thousands)	Amount	% of Total (1)	Amount	% of Total (1)	(decrease)
Commercial paper	$ 997,778	40%	$ 1,189,770	44%	$ (191,992)
Daily liquidity fund	478,406	100	308,725	100	169,681
Medium-term notes	499,222	21	371,961	10	127,261
Members' subordinated certificates	1,739,454	100	1,813,652	100	(74,198)
Total	$ 3,714,860		$ 3,684,108		$ 30,752
Percentage of total debt outstanding	20%		19%		

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

Member investments averaged $3,824 million outstanding over the last three fiscal years. We view member investments as a more stable source of funding than capital market issuances.

Cash Flows from Operations

For the year ended May 31, 2012, cash flows provided by operating activities were $119 million compared with cash flows provided by operating activities of $123 million for the prior year. Our cash flows from operating activities are driven primarily by a combination of cash flows from operations 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 May 31, 2012, we were in compliance with all covenants and conditions under our revolving credit agreements and senior debt indentures.

For calculating the required financial covenants in our revolving credit agreements, we adjust net income, senior debt and total equity to exclude the non-cash adjustments from the accounting for derivative financial instruments and foreign currency translation. Additionally, the TIER and senior debt to total equity ratio include the following adjustments:

- The adjusted TIER, as defined by the agreements, represents the interest expense adjusted to include the derivative cash settlements plus net income prior to the cumulative effect of change in accounting principle and dividing that total by the interest expense adjusted to include the derivative cash settlements.
- The senior debt to total equity ratio includes adjustments to senior debt to exclude RUS-guaranteed loans, subordinated deferrable debt and members' subordinated certificates. Total equity is adjusted to include subordinated deferrable debt and members' subordinated certificates. Senior debt includes guarantees; however, it excludes:

− guarantees for members where the long-term unsecured debt of the member is rated at least BBB+ by Standard & Poor's Corporation or Baa1 by Moody's Investors Service; and

− the payment of principal and interest by the member on the guaranteed indebtedness if covered by insurance or reinsurance provided by an insurer having an insurance financial strength rating of AAA by Standard & Poor's Corporation or a financial strength rating of Aaa by Moody's Investors Service.

The following represents our required and actual financial ratios under the revolving credit agreements at or for the years ended May 31:

	Requirement	Actual 2012	Actual 2011
Minimum average adjusted TIER over the six most recent fiscal quarters (1)	1.025	1.21	1.19
Minimum adjusted TIER for the most recent fiscal year (1) (2)	1.05	1.18	1.21
Maximum ratio of adjusted senior debt to total equity (1)	10.00	5.97	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 and debt-to-equity calculations include the adjustments set forth in the Non-GAAP Financial Measures section and exclude the results of operations for CAH.
(2) We must meet this requirement to retire patronage capital.

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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 May 31, 2012, the amount of our secured borrowings as defined under all three revolving credit agreements was $4,608 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 May 31, 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 at May 31:

		Actual	
	Requirement	2012	2011
Maximum ratio of adjusted senior debt to total equity (1)	20.00	7.68	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 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 USDA, 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 3, Loans and Commitments, for additional information related to collateral.

Although not required, we typically maintain pledged collateral and collateral on deposit in excess of the required 100 percent of the outstanding balance of debt issued. However, our revolving credit agreements limit pledged collateral to 150 percent of the outstanding balance of debt issued. The excess collateral ensures that required collateral levels are maintained and, when an opportunity exists, facilitates timely execution of debt issuances by reducing or eliminating the lead time required to pledge collateral. Collateral levels fluctuate because:

- distribution and power supply loans typically amortize, while the debt issued under secured indentures and agreements have bullet maturities;
- individual loans may become ineligible for various reasons, some of which may be temporary; and
- distribution and power supply borrowers have the ability to prepay their loans.

We may request the return of collateral pledged or held on deposit in excess of the 100 percent of the principal balance requirement or may move the collateral from one program to another to facilitate a new debt issuance, provided that all conditions of eligibility under the different programs are satisfied.

The $3,419 million of notes payable to the Federal Financing Bank as part of the funding mechanism for the Rural Economic Development Loan and Grant program at May 31, 2012 contain a rating trigger related to our senior secured credit ratings from Standard & Poor’s Corporation and Moody’s Investors Service. A rating trigger event

occurs if our senior secured debt does not have at least two of the following ratings: (i) A- or higher from Standard & Poor's Corporation, (ii) A3 or higher from Moody's Investors Service and (iii) an equivalent rating from a successor rating agency to any of the above rating agencies. If our senior secured credit ratings fall below the levels listed above, the mortgage notes on deposit at that time, which totaled $3,814 million at May 31, 2012, would be pledged as collateral rather than held on deposit. Also, if during any portion of a fiscal year our senior secured credit ratings fall below the levels listed above, we may not make cash patronage capital distributions in excess of 5 percent of total patronage capital. At May 31, 2012, our senior secured debt ratings from Standard & Poor's Corporation and Moody's Investors Service were A+ and A1 respectively. At May 31, 2012, both Standard & Poor's Corporation and Moody's Investors Service had our ratings on stable outlook.

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 at May 31:

	Requirement		Actual	
Debt agreement	Debt indenture minimum	Revolving credit agreements maximum	2012	2011
Collateral trust bonds 1994 indenture	100%	150%	107%	118%
Collateral trust bonds 2007 indenture	100	150	124	114
Federal Agricultural Mortgage Corporation	100	150	118	127
Clean Renewable Energy Bonds Series 2009A	100	150	109	118
Federal Financing Bank Series A (1)	100	150	110	111
Federal Financing Bank Series B (1)	100	150	111	116
Federal Financing Bank Series C (1)	100	150	108	117
Federal Financing Bank Series D (1)	100	150	123	123
Federal Financing Bank Series E (1)	100	150	119	-

(1) 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 May 31, 2012, unadvanced loan commitments totaled $14,129 million. Of that total, $1,303 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 48 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 52 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 $12,826 million of unadvanced loan commitments at May 31, 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 condition, financial or otherwise, 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 facilities, 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. Long-term unadvanced commitments generally expire five years from the date of the loan agreement. 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 May 31, 2012.

We currently expect to make long-term loan advances totaling approximately $1,750 million to our members over the next 12 months.

Interest Expense on Debt

For the year ended May 31, 2012, interest expense on debt was $741 million, representing an average cost of 4.05 percent compared with 4.42 percent and 4.71 percent for the years ended May 31, 2011 and 2010, respectively. For the past three fiscal years, interest expense on debt has averaged $817 million. At May 31, 2012, 86 percent of outstanding debt had a fixed interest rate and 14 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)	Amount Maturing (1)	Weighted-Average Interest Rate
May 31, 2013	$ 1,246,870	1.95%
May 31, 2014	2,648,066	3.91
May 31, 2015	872,834	2.02
May 31, 2016	1,008,070	3.09
May 31, 2017	606,868	5.40
Thereafter	8,774,773	5.36
Total	$ 15,157,481	4.48

(1) Excludes loan subordinated certificates totaling $151 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 2012, amortization represented 14 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 2012, the CFC Board of Directors approved the allocation of $71 million from fiscal year 2012 net earnings to CFC's members. CFC will make a cash payment of $35 million to its members in September 2012 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 52, we expect the amount of new long-term loan advances over the next six quarters to approximate scheduled long-term loan repayments. We offer long-term loans to our rural electric system members with maturities of up to 35 years, and the weighted average maturity for our electric loan portfolio is currently about 17 years. We offer long-term loans to our telecommunication members with maturities of up to 10 years, and the weighted average maturity for our telecommunications loan portfolio is currently about seven years. We also offer line of credit loans that are generally required to be paid down annually. We offer a variety of interest rate options on long-term loans including the ability to fix the interest rate for terms of one year through maturity. We fund the loan portfolio with a variety of debt instruments and our members' equity. We typically do not match fund each of our loans with a debt instrument of similar final maturity. Debt instruments such as membership subordinated certificates and loan and guarantee subordinated certificates have maturities that vary from the term of the associated loan or guarantee to 100 years; member capital securities have maturities of 35 years; and

subordinated deferrable debt has been issued with maturities of up to 49 years. We may issue collateral trust bonds and medium-term notes for periods of up to 30 years, but typically issue such debt instruments with maturities of two, three, five, seven and 10 years.

At May 31, 2012, we had $3,247 million of commercial paper, daily liquidity fund and bank bid notes scheduled to mature during the next 12 months. We expect to continue to maintain member investments in commercial paper and the daily liquidity fund at recent levels of approximately $1,500 million. Dealer commercial paper and bank bid notes decreased from $1,767 million at May 31, 2011 to $1,700 million at May 31, 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 May 31, 2012, 15 percent of total debt outstanding was $2,783 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 May 31, 2012, we had $2,844 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 May 31, 2012, we had long-term debt maturing in the next 12 months totaling $1,247 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:

- Based on our funding sources available and past history, we believe we will meet our obligation to refinance the remaining $233 million of medium-term notes sold through dealers and $410 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 we issued $1,305 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 $2,735 million available under this revolving note purchase agreement at May 31, 2012.
- At May 31, 2012, we had the ability to borrow up to $580 million from the Federal Financing Bank with a guarantee of repayment by RUS under the Guaranteed Underwriter program of the USDA, 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 $230 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. During the year ended May 31, 2012, we borrowed $269 million under our $499 million committed loan facility at a weighted average interest rate of 2.86 percent with a repricing period ranging from 10 to 15 years and a final maturity of 20 years. Subsequent to May 31, 2012, we borrowed $255 million under our committed loan facilities with the Federal Financing Bank.

At May 31, 2012, we are the guarantor and liquidity provider for $498 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 year ended May 31, 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 $191 million of cash on hand at May 31, 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 monthly 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

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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 May 31, 2012 and 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 May 31, 2012.

Interest Rate Gap Analysis
(Fixed-Rate Assets/Liabilities)
As of May 31, 2012

(dollar amounts in millions)	May 31, 2013 or prior	June 1, 2013 to May 31, 2015	June 1, 2015 to May 31, 2017	June 1, 2017 to May 31, 2022	June 1, 2022 to May 31, 2032	Beyond June 1, 2032	Total
Assets amortization and repricing	$ 2,659	$ 3,783	$ 2,707	$ 3,734	$ 2,999	$ 1,051	$ 16,933
Liabilities and members’ equity:							
Long-term debt	$1,740	$3,096	$ 2,595	$ 3,955	$ 2,183	$ 129	$13,698
Subordinated certificates	27	180	33	78	814	500	1,632
Members’ equity (1)	-	-	-	57	248	422	727
Total liabilities and members’ equity	$ 1,767	$ 3,276	$ 2,628	$ 4,090	$ 3,245	$ 1,051	$ 16,057
Gap (2)	$ 892	$ 507	$ 79	$ (356)	$ (246)	$ -	$ 876
Cumulative gap	892	1,399	1,478	1,122	876	876	
Cumulative gap as a % of total assets	4.47%	7.01%	7.41%	5.62%	4.39%	4.39%	
Cumulative gap as a % of adjusted total assets (3)	4.54	7.12	7.52	5.71	4.46	4.46	

(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 May 31, 2012, we had $16,933 million of fixed-rate assets amortizing or repricing, funded by $13,698 million of fixed-rate liabilities maturing during the next 30 years and $2,359 million of members’ equity and members’

subordinated certificates, a portion of which does not have a scheduled maturity. The difference of $876 million, or 4.39 percent of total assets and 4.46 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 May 31, 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 May 31, 2012 through committed revolving credit agreements totaling $2,844 million with domestic and foreign banks, $580 million under committed loan facilities from the Federal Financing Bank, and, subject to market conditions, up to $2,735 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 May 31, 2012 and 2011, there were no foreign currency derivative instruments outstanding.

We are required to record all derivative instruments in the consolidated balance sheets as either an asset or liability measured at fair value. Changes in the derivative instrument's fair value are required to be recognized currently in earnings unless specific hedge accounting criteria are met. Generally, our derivatives do not qualify for hedge accounting. A large portion of

our interest rate exchange agreements use a LIBOR index or the 30-day composite commercial paper index as the receive leg, which has not been highly correlated to our own commercial paper rates to qualify for hedge accounting on a consistent basis. We believe that the LIBOR index or the 30-day composite commercial paper index are the rates that most closely relate to the rates we pay on our own commercial paper, and, therefore, we believe we are economically hedging our net interest income on loans with our interest rate exchange agreements. At May 31, 2012 and 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.

The following table provides the notional amount, average interest rates and maturities by fiscal year for the interest rate exchange agreements to which we were a party at May 31, 2012.

(dollar amounts in millions)			Notional Amortization and Maturities					
Instruments	Fair Value	Notional Amount	2013	2014	2015	2016	2017	Thereafter
Interest rate exchange agreements	$ (358)	$ 8,996	$ 1,508	$ 1,306	$ 988	$ 838	$ 949	$ 3,407
Weighted-average pay rate		2.75%						
Weighted-average receive rate		2.20						

At May 31, 2012, 59 percent of our interest rate swaps were pay fixed-receive variable and 41 percent were pay variable-receive fixed. As a result, each 25-basis-point increase or decrease to the 30-day composite commercial paper index and the one-month and three-month LIBOR rates would result in a $4 million increase or decrease, respectively, in our net cash settlements. There were no cross currency or cross currency interest rate exchange agreements to which we were a party at May 31, 2012 and 2011.

Other Financial Instruments

The table below provides information about our financial instruments other than derivatives that are sensitive to changes in interest rates. All of our financial instruments at May 31, 2012 were entered into or contracted for purposes other than trading except for the investments in preferred stock. For debt obligations, the table presents principal cash flows and related average interest rates by expected maturity dates at May 31, 2012.

(dollar amounts in millions) Instrument	Outstanding Balance	Fair Value	Principal Amortization and Maturities 2013	2014	2015	2016	2017	Remaining Years
Assets:								
Investments in equity securities	$ 59	$ 59	$ -	$ -	$ -	$ -	$ -	$ 59
Long-term fixed-rate loans (1)	16,474	18,131	960	892	873	878	800	12,071
Average rate	5.48%		4.97%	5.11 %	5.24 %	5.24 %	5.33%	5.60%
Long-term variable-rate loans (2)	$ 782	$ 782	$ 56	$ 57	$ 48	$ 79	$ 52	$ 490

Average rate (3)	3.22%		-	-	-	-	-	-
Line of credit loans (4)	$ 1,159	$ 1,159	$ 1,159	$ -	$ -	$ -	$ -	$ -
Average rate (3)	2.27%		2.27%	-	-	-	-	-
Non-performing loans (5)	$ 41	$ 17	$ 27	$ 1	$ 1	$ 2	$ 2	$ 8
Average rate (5)	-		-	-	-	-	-	-
Restructured loans (5)	$ 456	$ 435	$ 9	$ 10	$ 10	$ 10	$ 11	$ 406
Average rate (5)	4.83%		-	-	-	-	-	-
Liabilities and equity:								
Short-term debt (6)	$ 4,493	$ 4,499	$ 4,493	$ -	$ -	$ -	$ -	$ -
Average rate	0.69%		0.69%	-	-	-	-	-
Medium-term notes	$ 1,781	$ 2,279	$ -	$ 361	$ 60	$ 27	$ 16	$ 1,317
Average rate	5.73%		-	1.85%	2.65%	3.67%	3.79%	6.99%
Collateral trust bonds	$ 6,053	$ 6,976	$ -	$ 1,805	$ 404	$ 954	$ 574	$ 2,316
Average rate	5.21%		-	4.53%	1.08%	3.08%	5.47%	7.28%
Long-term notes payable	$ 4,318	$ 4,681	$ -	$ 470	$ 381	$ 6	$ 5	$ 3,456
Average rate	3.33%		-	3.13%	2.86%	4.22%	4.22%	3.41%
Subordinated deferrable debt	$ 186	$ 187	$ -	$ -	$ -	$ -	$ -	$ 186
Average rate	6.02%		-	-	-	-	-	6.02%
Membership sub certificates (7)	$ 1,572	$ 1,730	$ -	$ 12	$ 28	$ 22	$ 12	$ 1,498
Average rate	5.25%		-	2.75%	2.80%	2.42%	4.94%	5.36%

(1) The principal amount of fixed-rate loans is the total of scheduled principal amortizations without consideration for loans that reprice. Includes $194 million of loans guaranteed by RUS.

(2) Long-term variable-rate loans include $24 million of loans guaranteed by RUS.

(3) Variable rates are set the first day of each month.

(4) The principal amount of line of credit loans are generally required to be paid down for a period of five consecutive days each year. These loans do not have a principal amortization schedule.

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(5) Amortization based on current repayment schedule. All non-performing loans were on non-accrual status at May 31, 2012. Average rate on restructured loans represents current accrual rate. Interest accrual rate cannot be estimated for future periods.
(6) Short-term debt includes commercial paper, bank bid notes and long-term debt due in less than one year.
(7) Carrying value and fair value exclude loan subordinated certificates totaling $151 million that amortize annually based on the outstanding balance of the related loan; therefore, there is no scheduled amortization. Over the past three years, annual amortization on these certificates has averaged $23 million. In fiscal year 2012, amortization represented 14 percent of amortizing loan subordinated certificates outstanding.

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 May 31, 2012 and 2011, the highest percentage concentration of total notional exposure to any one counterparty was 18 percent and 13 percent of total derivative instruments, respectively. 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 May 31, 2012, our derivative instrument counterparties had credit ratings ranging from AA to BBB+ as assigned by Standard & Poor’s Corporation and Aaa to Baa1 as assigned by Moody’s Investors Service. Based on the fair market value of our derivative instruments at May 31, 2012, there were three counterparties that would be required to make a payment to us totaling $45 million if all of our derivative instruments were terminated on that day. The largest amount owed to us by a single counterparty was $26 million, or 57 percent of the total exposure to us, at May 31, 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 May 31, 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 May 31, 2012, our senior unsecured credit rating from Moody’s Investors Service and Standard & Poor’s Corporation was A2 and A, respectively. At May 31, 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	$ (232)	$ -	$ (232)
fall below Baa1/BBB+ (1)	6,817,207	(290,053)	42,348	(247,705)
Total	$ 6,820,207	$ (290,285)	$ 42,348	$ (247,937)

(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 May 31, 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 May 31, 2012 was $297 million.

Subsequent to May 31, 2012, the Moody's Investors Service credit rating for one counterparty was downgraded to a level below the rating trigger level in the interest rate swap contracts with this counterparty. As a result, we have the option to terminate all interest rate swaps with this counterparty. At July 31, 2012, the interest rate swap contracts with this counterparty have a total notional amount of $717 million. If we were to decide to terminate the interest rate swaps with this counterparty, the contracts would be settled based on the fair value at the date of termination. At July 31, 2012, we estimate that we would have to make a payment of approximately $26 million to settle the interest rate swaps with this counterparty. We use our interest rate swaps as part of our matched funding strategy and do not generally terminate such agreements early. At this time, we have not provided notice to the counterparty that we intend to terminate the interest rate swaps. We will continue to evaluate the overall credit worthiness of this counterparty and to monitor our overall matched funding position.

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
Our primary performance measure is TIER. TIER is calculated by adding the interest expense to net income prior to the cumulative effect of change in accounting principle and dividing that total by the interest expense. TIER is a measure of our ability to cover interest expense requirements on our debt. We adjust the TIER calculation to add the derivative cash settlements to the interest expense and to remove the derivative forward value and foreign currency adjustments from total net income. Adding the cash settlements back to the interest expense also has a corresponding effect on our adjusted net interest income. We make these adjustments to our TIER calculation for covenant compliance on our revolving credit agreements.

We use derivatives to manage interest rate and foreign currency exchange risk on our funding of the loan portfolio. The derivative cash settlements represent the amount that we receive from or pay to our counterparties based on the interest rate indexes in our derivatives that do not qualify for hedge accounting. We adjust the reported interest expense to include the derivative cash settlements. We use the adjusted cost of funding to set interest rates on loans to our members and believe that the interest expense adjusted to include derivative cash settlements represents our total cost of funding for the period. For computing compliance with our revolving credit agreement covenants, we are required to adjust our interest expense to include the derivative cash settlements. TIER calculated by adding the derivative cash settlements to the interest expense reflects management's perspective on our operations and, therefore, we believe that it represents a useful financial measure for investors.

The derivative forward value and foreign currency adjustments do not represent our cash inflows or outflows during the current period and, therefore, do not affect our current ability to cover our debt service obligations. The derivative forward value included in the derivative losses line of the statement of operations represents a present value estimate of the future cash inflows or outflows that will be recognized as net cash settlements for all periods through the maturity of our derivatives that do not qualify for hedge accounting. Foreign currency adjustments represent the change in value of foreign-denominated debt resulting from the change in foreign currency exchange rates during the current period. The derivative forward value calculation is based on future interest rate expectations that may change daily, creating volatility in the estimated derivative forward value. The change in foreign currency exchange rates adjusts the debt balance to the amount that would be due at the reporting date. At the issuance date, we enter into a foreign currency exchange agreement for all foreign-denominated debt that effectively fixes the exchange rate for all interest and principal payments. For making operating decisions, we subtract the derivative forward value and foreign currency adjustments from our net income when calculating TIER and for other net income presentation purposes. The covenants in our revolving credit agreements also exclude the effects of derivative forward value and foreign currency adjustments. In addition, since the derivative forward value and foreign currency adjustments do not represent current period cash flows, we do not allocate such funds to our members and, therefore, exclude the derivative forward value and foreign currency adjustments from net income when making certain presentations to our members and in calculating the amount of net income to be allocated to our members. TIER calculated by excluding the derivative forward value and foreign currency adjustments from net income reflects management's perspective on our operations and, therefore, we believe that it represents a useful financial measure for investors.

The accounting for derivative financial instruments and foreign currency adjustments also affects our total equity. The derivative forward value and foreign currency adjustments flow through the consolidated statements of operations as income or expense, increasing or decreasing the total net income for the period. The total net income or net loss for the period represents an increase or decrease, respectively, to total equity. As a result of implementing the accounting for derivative financial instruments, our total equity includes other comprehensive income, which represents unrecognized gains and losses on derivatives. The other comprehensive income component of equity related to derivatives that qualify for hedge accounting does not flow through the consolidated statements of operations. As stated above, the derivative forward value and foreign currency adjustments do not represent current cash inflow or outflow. The other comprehensive income also is an estimate of future gains and losses and as such does not represent earnings that we can use to fund our loan portfolio. Financial measures calculated with total equity, excluding the accounting for derivative financial instruments and foreign currency adjustments, reflect management's perspective on our operations and, therefore, we believe represent a useful measure of our financial condition.

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 and foreign currency adjustments for the five years ended May 31:

(dollar amounts in thousands)	2012	2011	2010	2009	2008
Interest expense	$ (761,778)	$(841,080)	$ (912,111)	$ (935,021)	$ (931,268)
Derivative cash settlements	(12,846)	(6,848)	(23,304)	112,989	27,033
Adjusted interest expense	$ (774,624)	$(847,928)	$ (935,415)	$ (822,032)	$ (904,235)
Net interest income	$ 199,183	$ 167,831	$ 131,524	$ 135,743	$ 120,125
Derivative cash settlements	(12,846)	(6,848)	(23,304)	112,989	27,033
Adjusted net interest income	$ 186,337	$ 160,983	$ 108,220	$ 248,732	$ 147,158
Net (loss) income prior to cumulative effect of change in accounting principle	$ (148,797)	$ 151,215	$ 110,547	$ (73,770)	$ 39,646
Derivative forward value	223,774	23,388	(2,696)	160,017	98,743
Adjusted net income	$ 74,977	$ 174,603	$ 107,851	$ 86,247	$ 138,389

TIER using GAAP financial measures is calculated as follows:

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

Our adjusted TIER is calculated as follows:

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

The following table presents our TIER and adjusted TIER for the five years ended May 31:

	2012	2011	2010	2009	2008
TIER (1)	-	1.18	1.12	-	1.04
Adjusted TIER	1.10	1.21	1.12	1.10	1.15

(1) For the years ended May 31, 2012 and 2009, we reported a net loss of $149 million and $74 million, respectively; therefore, the TIER for these periods results in a value below 1.00.

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

Our adjusted leverage and debt-to-equity ratios include adjustments to:

- subtract debt used to fund loans that are guaranteed by RUS from total liabilities;
- subtract from total liabilities, and add to total equity, debt with equity characteristics issued to our members and in the capital markets; and
- exclude the non-cash impact of derivative financial instruments and foreign currency adjustments from total liabilities and total equity.

For computing compliance with our revolving credit agreement covenants, we are required to make these adjustments to our leverage ratio calculation. The revolving credit agreements prohibit us from incurring senior debt in an amount in excess of 10 times the sum of equity, members' subordinated certificates and subordinated deferrable debt, as defined by the agreements. In addition to the adjustments we make to calculate the adjusted leverage ratio, guarantees to our member systems that have an investment-grade rating from Moody's Investors Service and Standard & Poor's Corporation are excluded from the calculation of the leverage ratio under the terms of the revolving credit agreements.

We are an eligible lender under the RUS loan guarantee program. Loans issued under this program carry the U.S. government's guarantee of all interest and principal payments. Therefore, we have little or no risk associated with the collection of principal and interest payments on these loans. Therefore, we believe there is little or no risk related to the repayment of the liabilities used to fund RUS-guaranteed loans and we subtract such liabilities from total liabilities to calculate our leverage and debt-to-equity ratios. For computing compliance with our revolving credit agreement covenants, we are required to adjust our leverage ratio by subtracting liabilities used to fund RUS-guaranteed loans from total liabilities. The leverage and debt-to-equity ratios adjusted to subtract debt used to fund RUS-guaranteed loans from total liabilities reflect management's perspective on our operations and, therefore, we believe that these are useful financial measures for investors.

Members have been required to purchase subordinated certificates as a condition of membership and as a condition to obtaining a loan or guarantee. The subordinated certificates are accounted for as debt under GAAP. The subordinated certificates have long-dated maturities and pay no interest or pay interest that is below market, and under certain conditions we are prohibited from making interest payments to members on the subordinated certificates. For computing compliance with our revolving credit agreement covenants, we are required to adjust our leverage ratio by subtracting members' subordinated certificates from total liabilities and adding members' subordinated certificates to total equity. The leverage and debt-to-equity ratios adjusted to treat members' subordinated certificates as equity rather than debt reflect management's perspective on our operations and, therefore, we believe these are useful financial measures for investors.

We also sell subordinated deferrable debt in the capital markets with maturities of up to 39 years and the option to defer interest payments. The characteristics of subordination, deferrable interest and long-dated maturity are all equity characteristics. For computing compliance with our revolving credit agreement covenants, we are required to adjust our leverage ratio by subtracting subordinated deferrable debt from total liabilities and adding it to total equity. The leverage and debt-to-equity ratios adjusted to treat subordinated deferrable debt as equity rather than debt reflect management's perspective on our operations and, therefore, we believe these are useful financial measures for investors.

We record derivative instruments at fair value on our consolidated balance sheets. The fair values are estimates of the future gains and losses we may incur related to derivatives. The amounts do not represent current cash flows and are not available to fund current operations. For computing compliance with our revolving credit agreement covenants, we are required to adjust our leverage ratio by excluding the non-cash impact of our derivative accounting from liabilities and equity. The leverage and debt-to-equity ratios adjusted to exclude the impact of our derivative accounting from liabilities and equity reflect management's perspective on our operations and, therefore, we believe these are useful financial measures for investors. As a result of issuing foreign-denominated debt and the accounting standards for derivative financial instruments, which discontinued the practice of recording the foreign-denominated debt and the related currency exchange agreement as one transaction, we must adjust the value of such debt reported on the consolidated balance sheets for changes in foreign currency exchange rates since the date of issuance based on the accounting for foreign currency translation. At the time of issuance of all foreign-denominated debt, we enter into a foreign currency exchange agreement to fix the exchange rate on all principal and interest payments through maturity. The adjustments to the value of the debt on the consolidated balance sheets are reported on the consolidated statements of operations as foreign currency adjustments. The adjusted debt value at the reporting date does not represent the amount we will ultimately pay to retire the debt unless the current exchange rate is equal to the exchange rate in the related foreign currency exchange agreement or the counterparty fails to honor its obligations under the agreement. For computing compliance with our revolving credit agreement covenants, we are required to adjust our leverage ratio by excluding the impact of foreign currency valuation adjustments from liabilities and equity. The leverage and debt-to-equity ratios adjusted to exclude the effect of foreign currency translation reflect management's perspective on our operations and, therefore, we believe these are useful financial measures for investors.

The following table reconciles the liabilities and equity on the consolidated balance sheets to the amounts used to calculate the adjusted leverage and debt-to-equity ratios as of the five years ended May 31:

(dollar amounts in thousands)	2012	2011	2010	2009	2008
Liabilities	$ 19,460,580	$19,874,313	$19,556,448	$20,463,605	$18,699,169
Less:					
Derivative liabilities	(654,125)	(477,433)	(482,825)	(493,002)	(171,390)
Debt used to fund loans guaranteed by RUS	(219,084)	(226,695)	(237,356)	(243,997)	(250,169)

Subordinated deferrable debt	(186,440)	(186,440)	(311,440)	(311,440)	(311,440)
Subordinated certificates (1)	(1,739,454)	(1,813,652)	(1,810,715)	(1,740,054)	(1,406,779)
Adjusted liabilities	$ 16,661,477	$17,170,093	$16,714,112	$17,675,112	$16,559,391
Total equity	$ 490,755	$ 687,309	$ 586,767	$ 519,100	$ 680,212
Less:					
Prior year cumulative derivative forward value and foreign currency adjustments	142,252	118,864	121,560	(38,457)	(137,200)
Year-to-date derivative forward value loss (income)	223,774	23,388	(2,696)	160,017	98,743
Accumulated other comprehensive income (2)	(8,270)	(9,273)	(7,489)	(8,115)	(8,827)
Plus:					
Subordinated certificates (1)	1,739,454	1,813,652	1,810,715	1,740,054	1,406,779
Subordinated deferrable debt	186,440	186,440	311,440	311,440	311,440
Adjusted equity	$ 2,774,405	$ 2,820,380	$ 2,820,297	$ 2,684,039	$ 2,351,147
Guarantees	$ 1,249,330	$ 1,104,988	$ 1,171,109	$ 1,275,455	$ 1,037,140

(1) Includes $17 million and $12 million of subordinated certificates classified in short-term debt at May 31, 2012 and 2011, respectively.

(2) Represents the accumulated other comprehensive income related to derivatives. Excludes $0.9 million and $0.5 million of accumulated other comprehensive income related to the unrecognized gains on our investments at May 31, 2012 and 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, as of the five years ended May 31:

	2012	2011	2010	2009	2008
Leverage ratio	42.20	30.52	35.33	41.88	29.01
Adjusted leverage ratio	6.46	6.48	6.34	7.06	7.48
Debt-to-equity ratio	39.65	28.92	33.33	39.42	27.49
Adjusted debt-to-equity ratio	6.01	6.09	5.93	6.59	7.04

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

See Market Risk discussion beginning on page58.

Item 8. Financial Statements and Supplementary Data.

The consolidated financial statements, auditors' reports and quarterly financial results are included on pages 94 through 138 (see Note 16 to consolidated financial statements for a summary of the quarterly results of our operations).

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures
Senior management, including the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934. At the end of the period covered by this report, based on this evaluation process, the Chief Executive Officer

and Chief Financial Officer have concluded that our disclosure controls and procedures are effective at the reasonable assurance level.

Management’s Report on Internal Control Over Financial Reporting

The management of National Rural Utilities Cooperative Finance Corporation (“we,“our” or “us”) is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. Our internal control system over financial reporting is designed under the supervision of management, including the Chief Executive Officer and Chief Financial Officer, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in

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accordance with U.S. generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that:

(i.) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets;

(ii.) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of ours are being made only in accordance with authorizations of management and our directors; and

(iii.) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or dispositions of our assets.

Any system of internal control, no matter how well designed, has inherent limitations, including but not limited to the possibility that a control can be circumvented or overridden and misstatements due to error or fraud may occur and not be detected. Also, because of changes in conditions, internal control effectiveness may vary over time. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

A material weakness (as defined in PCAOB Auditing Standard No. 5) is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement in financial statements will not be prevented or detected on a timely basis.

Our management assessed the effectiveness of internal control over financial reporting as of May 31, 2012. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework.

Based on management's assessment and those criteria, management believes that we maintained effective internal control over financial reporting as of May 31, 2012.

This annual report on Form 10-K does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to the rules of the U.S. Securities and Exchange Commission that permit us to furnish only management's report with this annual report on Form 10-K.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

By: /s/ SHELDON C. PETERSEN
Sheldon C. Petersen

Chief Executive Officer
August 15, 2012

By: /s/ STEVEN L. LILLY
Steven L. Lilly
Senior Vice President and Chief Financial Officer
August 15, 2012

By: /s/ ROBERT E. GEIER
Robert E. Geier
Vice President and Controller

August 15, 2012

Item 9B. Other Information.

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

(a) Directors

Name	Age	Director since	Date present term expires
Delbert Cranford (President of CFC)	68	2007	2013
Burns E. Mercer (Vice President of CFC)	61	2008	2014
Joel Cunningham (Secretary-Treasurer of CFC)	58	2009	2015
Fred Anderson	60	2008	2014
Ray Beavers	57	2010	2013
Fred Brog	67	2009	2015
Raphael A. Brumbeloe	71	2007	2013
Mike Campbell	64	2012	2015
R. Grant Clawson	63	2011	2014
Walter K. Crook	72	2010	2013
Jim L. Doerstler	64	2008	2014
Jimmy Ewing, Jr.	64	2007	2013
Michael J. Guidry	63	2009	2013
Christopher L. Hamon	49	2009	2015
Scott W. Handy	54	2009	2015
William A. Kopacz	65	2006	2013
Lyle Korver	56	2010	2013
Glenn W. Miller	48	2009	2015
Curtis Nolan	54	2011	2013
Randy D. Renth	48	2009	2015
Dwight Rossow	50	2008	2014
R. Wayne Stratton	64	2007	2013
Kirk A. Thompson	49	2011	2014

Under CFC's bylaws, the board of directors must be composed of the following individuals:

- 20 directors, which must include one general manager and one director of a member system from each of 10 districts (but no more than one director from each state except in a district where only one state has members);
- two directors designated by the NRECA; and
- if the board determines at its discretion that an at-large director shall be elected, one at-large director who satisfies the requirements of an Audit Committee financial expert as defined by the Sarbanes-Oxley Act of 2002 and is a trustee, director, manager, Chief Executive Officer or Chief Financial Officer of a member.

The 20 district-level directors are each elected by a vote of the members within the district for which the director serves. The at-large director who satisfies the requirements of an Audit Committee financial expert is elected by the vote of all members. All CFC directors are elected for a three-year term and can serve a maximum of two consecutive terms. Each CFC member (other than associates) is entitled to one vote with respect to elections of directors in their districts.

(b) Executive Officers

Title	Name	Age	Held present office since
President and Director	Delbert Cranford	68	2012
Vice President and Director	Burns E. Mercer	61	2012
Secretary-Treasurer and Director	Joel Cunningham	58	2012
Chief Executive Officer	Sheldon C. Petersen	59	1995
Executive Vice President and Chief Operating Officer	John T. Evans	62	2011
Senior Vice President of Member Services and General Counsel	John J. List	65	1997
Senior Vice President and Chief Financial Officer	Steven L. Lilly	62	1994
Senior Vice President of Corporate Relations	Richard E. Larochelle	59	1998
Senior Vice President of Affiliate Organizations	Lawrence Zawalick	54	2011
Senior Vice President and Treasurer	Andrew Don	52	2011
Senior Vice President of Credit Risk Management	John M. Borak	67	2002

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The President, Vice President and Secretary-Treasurer are elected annually by the board of directors at its first organizational meeting immediately following CFC's annual membership meeting, each to serve a term of one year; the Chief Executive Officer serves at the pleasure of the board of directors; and the other Executive Officers serve at the pleasure of the Chief Executive Officer.

(c) Identification of Certain Significant Employees.

Inapplicable.

(d) Family Relationships.

No family relationship exists between any director or executive officer and any other director or executive officer of the registrant.

(e) (1) and (2) Business Experience and Directorships.

Mr. Cranford has served as a board director of Randolph Electric Membership Corporation in Asheboro, North Carolina since 1989 and was president from 1995 to 2002 and vice president from 1994 to 1995. He is a director and former president of the North Carolina Association of Electric Cooperatives, Inc. and also served on the North Carolina Electric Membership Corporation board. Mr. Cranford also serves on an advisory board for the Denton, North Carolina branch of First Bank, which is owned and operated by First Bancorp. He has been a retail pharmacist since 1966 and an owner of retail pharmacies since 1984. As a director of Randolph Electric Membership Corporation, Mr. Cranford has acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Cranford has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board.

Mr. Mercer has served as president and CEO of Meade County R.E.C.C. in Brandenburg, Kentucky since 1994. He serves as a board member for Kentucky Association of Electric Cooperatives, United Utility Supply Cooperative and Farmers Bank. Mr. Mercer is a former NCSC board member and was a member of the Kentucky Society of Certified Public Accountants. As president and CEO of Meade County R.E.C.C., Mr. Mercer has acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Mercer has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board. Mr. Mercer's experience with accounting principles, financial reporting rules and regulations and evaluating financial results makes him a valuable resource as a director of CFC.

Mr. Cunningham has been a director of Twin County Electric Power Association in Hollandale, Mississippi since 2004. He has been a self-employed certified public accountant in Belzoni, Mississippi since 1981. Mr. Cunningham is a member of the Mississippi Society of CPAs and the American Institute of CPAs. He also holds the Credentialed Cooperative Director Certificate issued by NRECA. As a director of Twin County Electric Power Association, Mr. Cunningham has acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Cunningham has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board. Mr. Cunningham's experience with accounting principles, financial reporting rules and regulations and evaluating financial results makes him a valuable resource as a director and member of the Audit Committee of CFC.

Mr. Anderson has been the president and CEO of New Hampshire Electric Cooperative, Inc. in Plymouth, New Hampshire since 1992. He is a founding board member of the New Hampshire Electric Co-op Foundation. Mr. Anderson is also a board member of the Cooperative Research Council and a former board member of Northway Bank and former member of Northway Bank's Audit Committee. Mr. Anderson is the former director of finance and

administration/CFO, New Hampshire Electric Cooperative, Inc.; systems accountant, Rural Electrification Administration; president, vice president and treasurer, Northeast Association of Electric Cooperatives; president, Northeast Public Power Association; and president, Consumer-Owned Energy Foundation. He holds the Credentialed Cooperative Director Certificate issued by the NRECA. Mr. Anderson also is a current member of the AICPA. As president and CEO of New Hampshire Electric Cooperative, Mr. Anderson has acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Anderson has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board. Mr. Anderson's experience with accounting principles, financial reporting rules and regulations and evaluating financial results makes him a valuable resource as a director and member of the Audit Committee of CFC.

Mr. Beavers has been the general manager and CEO of United Electric Cooperative Services in Cleburne, Texas since 1999. Mr. Beavers served as the board chairman of Texas Electric Cooperatives from 2008 to 2009 and as an alternate director of Brazos Electric Power Cooperative since 1999. Mr. Beavers was the chairman of the Rural Electric Management Development Council and former general manager and CEO of Southwest Rural Electric Association. In addition, he was the assistant to the general manager of Oklahoma Association of Electric Cooperatives and a member services coordinator of Cotton Electric Cooperative. As general manager and CEO of United Electric Cooperative Services, Mr. Beavers has

acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Beavers has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board.

Mr. Brog has been director of Lower Valley Energy in Afton, Wyoming since 1988. He has been a rancher and farmer in Freedom, Wyoming since 1970. Mr. Brog served as secretary-treasurer of NCSC and serves as a board member of Snake River Power Association. He was past president of Idaho Consumer-Owned Utilities Association and former director of Wyoming Rural Electric Association. In addition, Mr. Brog serves as president of Star Valley Cooperative Milk Marketing Association and adviser to the State of Wyoming Economic Development Committee. As a director of Lower Valley Energy, Mr. Brog has acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Brog has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board. Mr. Brog's experience with accounting, financial reporting and evaluating financial results makes him a valuable resource as a director and member of the Audit Committee of CFC.

Mr. Brumbeloe has served as a board director of Upson Electric Membership Corporation in Thomaston, Georgia since 1978 and has been board president since 1998. Mr. Brumbeloe has served as a board member of Georgia Electric Membership Corporation since 1983 and served as chairman from 1988 to 1989. Mr. Brumbeloe was elected to the board of Georgia Transmission Corporation in 2010. He is also a member representative of Oglethorpe Power Corporation. Mr. Brumbeloe retired from the Georgia State Patrol in 1995 and he has been owner of the Red Rock Armory since 1996. As a director of Upson Electric Membership Corporation, Mr. Brumbeloe has acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Brumbeloe has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board.

Mr. Campbell has been the executive vice president and general manager of Central Florida Electric Cooperative, Inc. in Chiefland, Florida since 2005. He has served as the vice president of engineering and operations of Coastal Electric Cooperative in Midway, Georgia from 1998 to 2005 and the engineering manager of Colquitt Electric Membership Corporation in Moultrie, Georgia from 1991 to 1998. He is serving as a trustee on the executive committee of Seminole Electric Cooperative, and as a director and secretary/treasurer of the Florida Rural Electric Self Insurer's Fund and Florida Rural Electric Credit Union. As a general manager of Central Florida Electric Cooperative, Mr. Campbell has acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Campbell has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board.

Mr. Clawson has been a trustee of Continental Divide Electric Cooperative in Grants, New Mexico since 1989. He represents District 10 on the NRECA Resolutions Committee. Mr. Clawson is a farmer and rancher and has been the owner of a custom saddle business since 1998. As a trustee of Continental Divide Electric Cooperative, Mr. Clawson has acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Clawson has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board.

Mr. Crook has been a director of Butler Public Power District in David City, Nebraska since 1991. Mr. Crook has served as the CEO of Polk & Butler Mutual Insurance Company since 1992 and is part owner of a farming operation. He also has served as the state director of Nebraska Rural Electric Association from 1997 to 1998 and 2008 to present. Mr. Crook is a director of Nebraska Farmers Mutual Reinsurance Company, an executive board member of the State Association of Mutual Insurance Companies of Nebraska and board chairman of Nebraska Rural TV Inc. He also holds the Credentialed Cooperative Director Certificate issued by NRECA. As a director of Butler Public Power District, Mr. Crook has acquired extensive experience with and knowledge of the rural electric cooperative industry

and, therefore, we believe Mr. Crook has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board.

Mr. Doerstler has served as a board director of Whitewater Valley REMC in Liberty, Indiana since 1994. He has served as an officer, an executive committee member and board member of the Indiana Statewide Association of Rural Electric Cooperatives. Mr. Doerstler has served as vice president of Farm Credit Banks of Louisville, vice president of credit for Wabash Valley Production Credit Association and branch manager of Greencastle Production Credit Association. He also holds the Credentialed Cooperative Director Certificate issued by NRECA. He is semi-retired and formerly owned and operated Louie's Boot Barn from 1987 until it was sold in June 2008. As a director of Whitewater Valley REMC, Mr. Doerstler has acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Doerstler has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board. Mr. Doestler's experience with accounting, financial reporting and evaluating financial results makes him a valuable resource as a director and member of the Audit Committee of CFC.

Mr. Ewing has served as a board director of Pointe Coupee Electric Membership Corporation in New Roads, Louisiana since 1989 and has been board president since 1995. He served as secretary/treasurer from 1990 to 1995. He also serves as a board member of the Association of Louisiana Electric Cooperatives, Inc. and has been secretary-treasurer since 2006. He is currently president of the board at the Association of Louisiana Electric Cooperatives. He is a member of the Action Committee for Rural Electrification and a former board member of Cajun Electric Power Cooperative. He also holds the Credentialed Cooperative Director Certificate issued by NRECA. Mr. Ewing has been a restaurant owner since 1988 and a farm manager since 2002. As a director of Pointe Coupee Electric Membership Corporation, Mr. Ewing has acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Ewing has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board.

Mr. Guidry serves as president of NRECA and previously served as vice president and secretary-treasurer of NRECA. In addition, he is a former member of NRECA Management Advisory Committee and former member of NRECA Resolutions Committee, as well as a current director of the South Louisiana Economic Council and chairman of the South Louisiana Economic Council Regional Economic Development Committee. He also holds the Credentialed Cooperative Director Certificate issued by NRECA. Mr. Guidry served as general manager of South Louisiana Electric Association in Houma, Louisiana from 1989 until his retirement on January 13, 2012. Mr. Guidry also previously served as alternate director of Cajun Electric Power Cooperative and president of Louisiana Distribution Co-op Managers Association. As general manager of South Louisiana Electric Association, Mr. Guidry acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Guidry has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board. Mr. Guidry’s experience with accounting, financial reporting and evaluating financial results makes him a valuable resource as a director and member of the Audit Committee of CFC.

Mr. Hamon has been the CEO of White River Valley Electric Cooperative, Inc. in Branson, Missouri since 1985. He currently serves as director and served as past president of Sho-Me Power Electric Cooperative and alternate director of KAMO Power. Mr. Hamon serves on the Executive Board, as president of the Alternative Fuel Taskforce and on multiple committees for the Association of Missouri Electric Cooperatives and was past president of the Cooperative Managers Group. In addition, he was the former Operations and Engineering manager for White River Valley Electric Cooperative. Mr. Hamon is a member of the Energy Efficiency/Demand Side Management Team for Associated Electric Cooperative, Inc., the Institute of Electrical & Electronic Engineers and the Missouri Society of Professional Engineers. As CEO of White River Valley Electric Cooperative, Mr. Hamon has acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Hamon has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board.

Mr. Handy has been the president and CEO of Cass County Electric Cooperative, Inc. in Fargo, North Dakota since February 2002 and has been employed there in various capacities since October 1982. He has previously served as chairman for the Rural Electric Management Development Council, Minnkota Power Cooperative Manager’s Advisory Committee and the North Dakota Association of Rural Electric Cooperatives Manager’s Advisory Committee. In addition, he is board chairman for Greater Fargo-Moorhead Economic Development Corporation’s Growth Initiative Fund, a public/private loan pool that lends money for business expansion, and board member of the North Dakota State University Quentin N. Burdick Center for Cooperatives. As president and CEO of Cass County Electric Cooperative, Mr. Handy has acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Handy has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board. Mr. Handy’s experience with accounting, financial reporting and evaluating financial results makes him a valuable resource as a director and member of the Audit Committee of CFC.

Mr. Kopacz has been the general manager of Midstate Electric Cooperative, Inc. in La Pine, Oregon since 1990. He is currently a board director of Northwest Requirement Utilities, Northwest Irrigation Utilities and Mid Oregon Credit Union. He also is a former board president of Economic Development for Central Oregon. He is a former director of Ruralite Services, a northwest electric cooperative publication, and former president of the Oregon Rural Electric Cooperative Association. As general manager of Midstate Electric Cooperative, Mr. Kopacz has acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Kopacz has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board.

Mr. Korver has been the general manager and CEO of North West Rural Electric Cooperative in Orange City, Iowa since 1993. In addition, he was the secretary-treasurer and past chairman of the Resolutions Committee of Mid-West Electric Consumers Association. Mr. Korver was the general manager of Sioux Electric Cooperative Association from 1984 to 1993 and the shared general manager of Sioux Electric Cooperative Association and O'Brien County Rural Electric Cooperative from 1989 to 1993. Mr. Korver was the manager's representative to the board of the Iowa Association of Electric Cooperatives from 2005 to 2006. He also was a member of NRECA Marketing and Energy Services Committee. He is an

ACRE President's Club member. Mr. Korver has been the president of Orange City Development Corporation since 2007. As general manager and CEO of North West Rural Electric Cooperative, Mr. Korver has acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Korver has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC Board. Mr. Korver's experience with accounting, financial reporting and evaluating financial results makes him a valuable resource as a director and member of the Audit Committee of CFC.

Mr. Miller has been the president and CEO of Holmes-Wayne Electric Cooperative, Inc. in Millersburg, Ohio since 2004. He currently serves on the board of Buckeye Power, Inc. including the Executive, Audit and Rate committees. Mr. Miller is currently serving on the board of Wayne Savings Community Bank located in Wooster, Ohio, where he also serves on both the Loan and Audit Committees. Mr. Miller is a certified public accountant and owner of Glenn W. Miller, CPA. In addition, he is a board member and treasurer of Holmes County Economic Development Council, Inc. and board member of Holmes-Wayne Electric Foundation, Inc. Mr. Miller is a part-owner and vice president of The Pines Golf Club in Orrville, Ohio. As president and CEO of Holmes-Wayne Electric Cooperative, Mr. Miller has acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Miller has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board. Mr. Miller's experience with accounting principles, financial reporting rules and regulations and evaluating financial results makes him a valuable resource as a director and member of the Audit Committee of CFC.

Mr. Nolan has been a director of Sulphur Springs Valley Electric Cooperative in Willcox, Arizona since 1993 and a director of NRECA since 2002. Mr. Nolan has also been serving as vice president of NRECA since March 2011. Mr. Nolan previously served as president and secretary of the Sulphur Springs Valley Electric Cooperative and as a secretary-treasurer of NRECA. He is a former director and a chairman of Southwest Transmission Cooperative and a former director, treasurer and secretary for Grand Canyon State Electric Cooperative Association. Mr. Nolan has been the owner of Nolan Builders since 2005. Mr. Nolan also is a Credentialed Cooperative Director through NRECA and holds a Board Leadership Certificate. As a director of Sulphur Springs Valley Electric Cooperative, Mr. Nolan has acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Nolan has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board.

Mr. Renth has been director of Clinton County Electric Cooperative in Breese, Illinois since 1997. He is a certified public accountant and has been at Rickhoff & Associates LTD of O'Fallon, Illinois from 2011 to current and from 2007 to 2009. Mr. Renth was at Rehkemper & Son, Inc. of St. Rose, Illinois from 2009 to 2011. Mr. Renth was the controller of Auffenberg Auto Group in St. Louis, Missouri from 2006 to 2007. Also in 2006, he served as the plant controller for Cenveo, Inc. in St. Louis, Missouri. Mr. Renth served as the chief financial officer of Archway International Trucks/Gateway City International in St. Louis, Missouri from 1997 to 2006. In addition, he is a member of the American Institute of CPAs and the Illinois Society of CPAs. He also holds the Credentialed Cooperative Director Certificate issued by NRECA. Mr. Renth is owner and operator of RDR Acres Inc., a family farm corporation. As a director of Clinton County Electric Cooperative, Mr. Renth has acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Renth has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board. Mr. Renth's experience with accounting principles, financial reporting rules and regulations and evaluating financial results makes him a valuable resource as a director and member of the Audit Committee of CFC.

Mr. Rossow has served as a board director of Cam Wal Electric Cooperative in Selby, South Dakota since 1996. Mr. Rossow also is a board member of South Dakota Rural Electric Association. Mr. Rossow has been a self-employed rancher in Herreid, South Dakota since 1980 and is the owner of Rossow Feedlot Cleaning, LLC. He also holds the Credentialed Cooperative Director Certificate issued by NRECA. As a director of Cam Wal Electric Cooperative, Mr.

Rossow has acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Rossow has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board.

Mr. Stratton has been a board director of East Kentucky Power Cooperative in Winchester, Kentucky since 1990. He has served as a director of Shelby Energy Cooperative since 1987, ACES Power Marketing (2004-2011), Shelbyville Municipal Water & Sewer Commission since 2000 and Republic Bancorp since 1995. He is an at-large director that serves as the Audit Committee financial expert as defined by the Securities and Exchange Commission. He is a certified public accountant in Kentucky, accredited in Business Valuation by the AICPA, a Certified Forensic Accountant, Certified Fraud Examiner and a Credentialed Cooperative Director through NRECA. Mr. Stratton has been a member/owner of Jones, Nale & Mattingly PLC, a full-service accounting and auditing practice since 1970. He currently serves as the Audit Committee chairman and Audit Committee financial expert of Republic Bancorp, a $3,400 million bank traded on NASDAQ. Mr. Stratton is the Audit Committee chairman of East Kentucky Power Cooperative, former team captain for AICPA peer reviews of other accounting firms and former board member of Kentucky Higher Education Assistance Authority where as chairman for eight years, he participated in various finance transactions. He served on the AICPA Uniform Accountancy Act Committee and is the past president of the Kentucky Society of CPAs. As a director of East Kentucky Power Cooperative, Mr. Stratton has acquired

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extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Stratton has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board. Mr. Stratton's experience with accounting principles, financial reporting rules and regulations and evaluating financial results makes him a valuable resource as a director and member of the Audit Committee of CFC.

Mr. Thompson has been the general manager of CMS Electric Cooperative, Inc., in Meade, Kansas since 1991. Mr. Thompson is board president of Kansas Electric Power Cooperative and board president of High Plains Energy LLC. Mr. Thompson is also the board president of Southwest Kansas Area Cooperative District 613. As general manager of CMS Electric Cooperative, Mr. Thompson has acquired extensive experience with and knowledge of the rural electric cooperative industry and, therefore, we believe Mr. Thompson has the qualifications, skills and experience necessary to act in the best interests of CFC and to serve as a director on the CFC board. Mr. Thompson's experience with accounting, financial reporting and evaluating financial results makes him a valuable resource as a director and member of the Audit Committee of CFC.

Mr. Petersen joined CFC in August 1983 as an area representative. He became the director of Policy Development and Internal Audit in January 1990, director of Credit Analysis in November 1990 and Corporate Secretary on June 1, 1992. He became Assistant to the Governor on May 1, 1993. He became Assistant to the Governor and Acting Administrative Officer on June 1, 1994. He became Governor and CEO on March 1, 1995. Mr. Petersen began his career in the rural electrification program in 1976 as staff assistant for Nishnabotna Rural Electric Cooperative in Harlan, Iowa. He later served as General Manager of Rock County Electric Cooperative Association in Janesville, Wisconsin.

Mr. Evans joined CFC as Senior Vice President of Operations in November 1997. On June 1, 2010, Mr. Evans became Executive Vice President and Chief Operating Officer. He was Senior Vice President and Chief Operating Officer of Suburban Hospital Healthcare System, Bethesda, Maryland from 1994 to 1997. He was Senior Vice President and Chief Operating Officer for Geisinger Medical Center, Danville, Pennsylvania from 1991 to 1994.

Mr. List joined CFC as a staff attorney in February 1972. He served as Corporate Counsel from June 1980 to 1991. He became Senior Vice President and General Counsel on June 1, 1992, and became Senior Vice President, Member Services and General Counsel on February 1, 1997.

Mr. Lilly joined CFC as a Senior Financial Consultant in October 1983. He became director of Special Finance in June 1985 and director of Corporate Finance in June 1986. He became Treasurer and Principal Finance Officer on June 1, 1993, and became Senior Vice President and Chief Financial Officer on January 1, 1994.

Mr. Larochelle joined CFC as director of Corporate Relations in May 1996. He became Senior Vice President of Corporate Relations in August 1998. Before joining CFC, he was the Legislative Director at NRECA where he worked for 12 years. He also worked at the USDA in the Rural Electrification Administration and the Farmers Home Administration.

Mr. Zawalick joined CFC in 1980. Throughout his career with CFC, Mr. Zawalick has held various positions. In February 2000, Mr. Zawalick was named CFC's Senior Vice President of RTFC. On June 1, 2010, Mr. Zawalick was named Senior Vice President, Affiliate Organizations, which includes oversight responsibilities for both RTFC and NCSC operations.

Mr. Don joined CFC in September 1999 as Director of Loan Syndications and became Vice President of Capital Market Relations in June 2005. Effective June 2010, Mr. Don became CFC's Senior Vice President and Treasurer. Prior to joining CFC, he held the position of Vice President and Manager of the Washington, D.C. Office for The

Bank of Tokyo–Mitsubishi. Mr. Don started his banking career with the Bank of Montreal in New York in 1984 and subsequently was a Vice President for Corporate Banking for The Bank of New York from 1987 to 1990.

Mr. Borak joined CFC in June 2002 as Senior Vice President, Credit Risk Management. Previously, he was with Fleet National Bank, Boston, Massachusetts from 1992 to 2001 where he was a Senior Credit Officer with risk management and loan approval responsibility for several industry banking portfolios including investor-owned utilities. Prior assignments at Fleet in Hartford, Connecticut included Manager of Credit Review and Manager of Loan Workout in Connecticut.

(f) Involvement in Certain Legal Proceedings.

None to our knowledge.

(g) Promoters and Control Persons.

Inapplicable.

(h) Code of Ethics

We have adopted a Code of Ethics within the meaning of Item 406(b) of Regulation S-K. This Code of Ethics applies to our principal executive officer, principal financial officer and principal accounting officer. This Code of Ethics is publicly available on our website at www.nrucfc.coop (under the link "About CFC/Corporate Governance").

(i) Nominating Committee

Our board of directors does not have a standing nominating committee. As described above under "Part III – Item 10(a) Directors," 20 of our directors are each elected by members in the district for which the director serves. To nominate director candidates, at the district meeting before the meeting at which candidates are to be elected from such district, a nominating committee is elected composed of one person from each state within the district. Each member of the nominating committee must be a trustee, director or manager of one of our members. Each district nominating committee then submits names of two or more nominees for each position in the district for which an election is to be held. We provide members of the nominating committee with director guidelines to use as an aide in reviewing applications from potential candidates. Our board of directors believes that it is appropriate for each nominating committee with respect to district-level director elections to consist of member representatives rather than directors because of our unique, localized election process. One or more candidates for the at-large director who satisfies the requirements of an Audit Committee financial expert are nominated by our board of directors if the board determines that it is appropriate to fill the seat. Our board of directors believes that it is appropriate for the full board of directors to nominate this director because of the position's specific qualification requirements and the lack of any local district qualification requirement.

While we do not have a formal policy regarding diversity, the director guidelines we provide to each district nominating committee specify that a variety of perspectives, opinions and backgrounds is critical to the board's ability to perform its duties and various roles. We recognize the value of having a board that encompasses a broad range of skills, expertise, industry knowledge and diversity of professional and personal experience.

(j) Audit Committee

Our Audit Committee currently consists of 13 directors: Mr. Miller (Chairperson), Mr. Thompson (Vice Chairperson), Mr. Stratton (Vice Chairperson), Mr. Cranford (Ex Officio), Mr. Brumbeloe, Mr. Crook, Mr. Cunningham, Mr. Doerstler, Mr. Ewing, Mr. Handy, Mr. Korver, Mr. Nolan and Mr. Renth. Mr. Stratton was designated by the board as the "Audit Committee financial expert" as defined by Section 407 of the Sarbanes-Oxley Act of 2002. The members of the Audit Committee are "independent" as that term is defined in Rule 10A-3 under the Securities Exchange Act. Among other things, the Audit Committee reviews our financial statements and the disclosure under Management's Discussion and Analysis in our Annual Report on Form 10-K. The Audit Committee meets with our independent registered public accounting firm, internal auditors, CEO and financial management executives to review the scope and results of audits and recommendations made by those persons with respect to internal and external accounting controls and specific accounting and financial reporting issues and to assess corporate risk. The board has adopted a written charter for the Audit Committee that may be found on our website, www.nrucfc.coop (under the link "About CFC/Corporate Governance").

The Audit Committee completed its review and discussions with management regarding our audited financial statements for the year ended May 31, 2012. The Audit Committee has discussed with the independent auditors the matters required to be discussed by Statement on Auditing Standards No. 114, and received from the independent accountants written disclosures and the letter from the independent accountant required by applicable requirements of the Public Company Accounting Oversight Board regarding the independent accountant's communications with the Audit Committee concerning independence, and discussed with the independent accountants their independence.

Based on the review and discussions noted above, the Audit Committee recommended to the board that the audited financial statements be included in our Annual Report on Form 10-K for the year ended May 31, 2012 for filing with the Securities and Exchange Commission.

(k) Compensation Committee

Role of the Compensation Committee
Our Compensation Committee currently consists of seven directors: Mr. Cranford, Mr. Mercer, Mr. Cunningham, Mr. Beavers, Mr. Korver, Mr. Handy and Mr. Miller. The Compensation Committee of the board of directors reviews and makes appropriate recommendations to the full board of directors regarding CFC's total compensation philosophy and pay components, including, but not limited to, base and incentive pay programs. The Compensation Committee is also responsible for approving the compensation, employment agreements and perquisites for the CEO. The Compensation Committee annually reviews all approved corporate goals and objectives relevant to compensation, evaluates performance in light of those goals and approves the CEO's compensation based on this evaluation, all of which is then submitted to the full board of

directors for ratification. The Compensation Committee has delegated authority to the CEO for evaluating the performance and approving the annual base compensation for all of the other named executive officers as identified in the Summary Compensation Table below. Other than the CEO, no other named executive officer makes decisions regarding executive compensation.

The Compensation Committee reports to the board of directors on its actions and recommendations following committee meetings and meets in executive session without members of management present when making specific compensation decisions. Although the board has delegated authority to the Compensation Committee with respect to CFC's executive and general employee compensation programs and practices, the full board of directors also reviews and ratifies CFC's compensation and benefit programs each year.

The Compensation Committee's charter can be found on our website at www.nrucfc.coop (under the link "About CFC/Corporate Governance").

The Compensation Committee's Processes

The Compensation Committee has established a process to assist it in ensuring that CFC's executive compensation program is achieving its objectives. Prior to the start of each fiscal year, the board of directors approves performance measures for the "corporate balanced scorecard," which is the basis for the short-term incentive plan, and the specific goal and metrics for the long-term incentive plan. The Compensation Committee reviews and assesses the accomplishment of goals as of the end of the fiscal year and determines whether to authorize the payment of incentive compensation. This authorization is then submitted to the full board of directors for ratification.

The President, Vice President and Secretary-Treasurer of the board of directors meets annually with the CEO to review his performance based on his individual achievements, contribution to CFC's performance and other leadership accomplishments. In determining Mr. Petersen's base pay, the Compensation Committee subjectively considers a variety of corporate performance measures, including financial metrics, portfolio management, customer satisfaction and market share, industry leadership, and peer group compensation data provided by the compensation consultant, as discussed below.

Role of Compensation Consultant

In fiscal year 2012, the Compensation Committee hired Mercer (US) Inc. ("Mercer") to advise it on the CEO's compensation as compared with the compensation of CEOs of peer group organizations. Through discussions with the Compensation Committee, Mercer established a peer group of companies to use in assessing the competitiveness of the CEO's compensation (see "Compensation Analysis" in the Compensation Discussion and Analysis section below). Mercer advised the Compensation Committee through an assessment of compensation data from this peer group using both a one-year compensation analysis, which assesses CFC's CEO compensation and the compensation of peer CEOs for the most recent fiscal year, and a three-year compensation analysis, which assesses average peer CEO pay for the last three fiscal years. Compensation analyses include peer group CEO base pay, actual and target, annual incentives, actual and target total cash compensation, one year and three year average long-term incentives and total direct compensation. Mercer did not determine or provide the Compensation Committee with a specific recommendation on any component of executive compensation.

Role of Executive Officers

As described above, the Compensation Committee has delegated the authority for making base pay decisions for the other named executive officers to the CEO. The CEO exercises his judgment to set base pay rates, based on general market data, overall corporate performance and leadership accomplishments. For additional information about the CEO's role in compensation decisions, see "Base Pay" under the Compensation Discussion and Analysis section below.

(k) Section 16(a) Beneficial Ownership Reporting Compliance

Inapplicable.

(l) Board Leadership Structure and Role of Risk Oversight by the board of directors

Board Leadership Structure

The positions of CEO and President of the CFC Board of Directors are held by two separate individuals. The President must be a member of the board of directors and is elected annually by the board of directors. The President of the CFC Board of Directors has authority, among other things, to appoint members of the board to standing committees, to appoint a vice chairperson to each Board standing committee and to appoint members to ad-hoc Board committees. The President of the board presides over Board meetings, sets meeting agendas and determines materials to be distributed to the board. Accordingly, the board president has substantial ability to influence the direction of the board. CFC believes that separation of the positions of Board President and CEO reinforces the independence of the board in its oversight of its business and affairs. CFC also believes that this leadership structure is appropriate in light of the cooperative nature of the organization.

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The board of directors appoints the CEO. The CEO is not a member of the board of directors. If the CEO position becomes vacant, the President will exercise the responsibilities of the CEO until a permanent or interim CEO is selected by the board of directors.

Board Role in Risk Oversight
CFC's management has primary responsibility for day-to-day management of the risks associated with CFC's business, including operational, credit, loan, asset and liability management, legal, regulatory and political risks, while the board of directors is primarily responsible for the oversight and direction of risk management. Management's role includes identifying risks, establishing appropriate internal processes and an effective internal control environment to identify and manage risks, and communicating information about risk to the board. CFC's management, consisting of the Executive Team and the Operations and Planning Council, which is composed of 8 vice president-level employees, is assisted in its day-to-day duties related to risk by individual business functions, in addition to an Asset Liability Committee, Corporate Credit Committee and Disclosure Committee, which are authorized by the board of directors and have their members appointed by the CEO. Each of these internal, multi-department committees consists of certain management-level employees.

In fulfilling its risk management oversight duties, the board of directors receives periodic reports on business activities from management and from various operating groups and committees across the organization, including the Credit Risk Management group, the Member Services group, the Internal Audit group and the Corporate Compliance Officer, as well as the Asset Liability Committee, the Corporate Credit Committee and the Disclosure Committee. The board of directors also reviews CFC's risk profile and management's response to those risks throughout the year at its meetings.

CFC has an annual strategic planning process that involves the board of directors, the Executive Team and the Operations and Planning Council.

The process begins with a review of the strategic risk assessment. This session provides the Executive Team an opportunity to discuss the risk assessment with the board of directors and to discuss other pertinent strategic topics. The objective of the risk assessment is to identify significant business risks facing CFC that could impede our ability to achieve our strategic goals. The result of the risk assessment is a listing of significant business risks that are prioritized based on likelihood and impact. The board of directors develops a risk management philosophy, which states CFC's set of shared beliefs and attitudes on how risk is considered from strategy development and implementation to our operations.

The Operations and Planning Council periodically coordinates operational risk assessment sessions, which involve the Executive Team and other senior managers from across the organization. Before the risk assessment session, the Operations and Planning Council requests participants to prioritize the operational risks within CFC's risk management framework. The Internal Audit team compiles the risk rankings based on the responses received from participants and determines the overall top 10 risks. During the risk assessment session, the participants assess the likelihood and impact for each of the 10 top risks using a high, medium and low scale without any regard to mitigation strategies.

The board of directors has established a risk appetite that includes a common understanding between executive management and the board of directors regarding acceptable risks and risk tolerances underlying the execution of CFC's strategy. It is also intended as a benchmark for discussing the implications for pursuing new strategies and business opportunities.

The results of the board's strategic risk assessment and management's operational risk assessment are used as the basis for the development of the strategic plan.

Additionally, the Risk Committee of the Operations and Planning Council periodically conducts a risk culture survey to assess the strengths and weaknesses of our corporate culture in the following areas: management's philosophy and operating style, risk management activities, organizational structure, integrity and ethical values. The Operations and Planning Council then provides the Executive Team with recommended action items that are focused on improving the internal control environment.

CFC's Audit Committee assists the board of directors in its risk oversight responsibilities. In accordance with its charter, CFC's Audit Committee is required to periodically inquire of the internal auditors and the external auditors regarding significant risks and exposures to the organization, as well as inquire as to the steps management has taken or proposes to take to minimize these risks. The Audit Committee periodically reviews compliance with such steps. The Corporate Compliance group provides the Audit Committee with semi-annual reports on compliance and ethics matters, including any breaches of laws, regulations or organizational standards. In addition, the Internal Audit group provides the Audit Committee with feedback on the effectiveness and design of internal control processes by reporting the results of its internal audits.

Item 11. Executive Compensation.

Compensation Discussion and Analysis
Executive Compensation Philosophy and Objectives
The components of our compensation package for the named executive officers (consisting of Messrs. Petersen, Evans, Lilly, List and Larochelle) are consistent with those offered to all employees.

Our executive compensation program provides a balanced mix of compensation that incorporates the following key components:

- annual base pay,
- an annual cash incentive that is based on the achievement of short-term (one-year) corporate goals,
- a three-year cash incentive that is based on the achievement of longer-term corporate goals, and
- retirement, health and welfare and other benefit programs provided generally to all CFC employees.

While all elements of executive compensation work together to provide a competitive compensation package, each element of compensation is determined independently of the other elements.

Our compensation philosophy is to target total compensation for employees – base pay, short-term incentive, long-term incentive and benefits – at the 75th percentile of market for the general employee population. However, due to the cooperative nature of the organization, CFC does not meet the compensation levels of named executive officers of other financial services organizations at the 75th percentile since we do not offer stock or other equity compensation. It is important to CFC, however, to pay the named executive officers of CFC competitively in base pay to retain key talent.

Performance –Named executive officers receive base pay that is both market competitive and reflective of the strategic management they provide to CFC. Other components of compensation – short-term and long-term incentives – reflect the performance of the organization and the success in achieving performance metrics established by the board of directors.

Retention – CFC's success is due in large part to the relationship between our employees and our members. This makes the retention of employees, including the named executive officers, vital to our business and long-term success. The compensation package, particularly the long-term incentive plan and the retirement benefits, assist in the retention of a highly qualified management team.

Compensation Analysis
In fiscal year 2012, Mercer was engaged by the Compensation Committee to conduct a compensation survey to provide compensation data for the CEO position using 13 peer organizations identified by Mercer through interviews with the Compensation Committee. Mercer included companies in the compensation comparison group that were similar to CFC in asset size, industry and business description. The group included financial institutions that are private market, commercial and/or mission-driven lenders, offering full-service financing, investment and related services. The companies targeted as peer companies included three members of the Farm Credit system and 11 regional banks or financial services companies. These companies were chosen because their businesses are similar to CFC's.

The targeted companies had assets ranging from approximately 50 percent to 200 percent of CFC's December 2010 total assets of $20,560 million, and included seven companies with greater total assets than CFC's. The comparator group consisted of financial services organizations New York Community Bancorp, Inc., Astoria Financial Corp., Nelnet, Inc., Webster Financial Corp., Flagstar Bancorp, People's United Financial Corp., Washington Federal Inc., Hudson City Bancorp Inc., First Niagara Financial Group, and Federal Agricultural Mortgage Corporation, as well as

three Farm Credit System peers. Although Hudson City Bancorp Inc.'s 2010 assets are outside of the normal targeted asset range, Mercer recommended that this company remain in the peer group.

Mercer led the Compensation Committee through an assessment of CEO compensation data at the comparator group companies using both a one-year and a three-year compensation analysis. Mercer's data included both actual compensation

and target compensation based on information obtained from each comparator group company's most recent annual report or proxy statement. The elements of compensation reviewed include:

- current base salary;
- actual bonus paid for fiscal year 2010*;
- three-year average actual long-term incentive paid, which includes restricted stock awards (valued at face value on the date of grant), stock option awards (valued at grant date utilizing the Black-Scholes option pricing model), other long-term incentive target awards (valued at target value on date of award) and cash long-term incentive payouts (valued at actual payout on date of award if target value is not disclosed); and
- sign-on awards, special awards and mega-grants annualized over the term of employment contract or the vesting schedule.

* For targeted compensation, the target bonus for 2011 was used.

The Compensation Committee reviewed total compensation data for the comparator group for informational purposes and used this data solely to determine the competitiveness of our CEO base pay.

In determining the base compensation paid to our other named executive officers, the CEO reviewed national, credible third-party compensation surveys (including the Mercer Executive and CompAnalyst surveys) for financial services and other organizations of similar asset size as CFC in order to obtain a general understanding of current compensation practices and to ensure that the base pay component of compensation for the named executive officers other than the CEO is competitive with such institutions. CFC has historically recruited non-CEO talent from industries outside the financial services sector. As a result, the CEO considers data from surveys covering a larger and broader group of for-profit companies in setting compensation for the other named executive officers than the Compensation Committee considers in setting compensation for the CEO. The CEO considered the data to gain a general understanding of current compensation practices at institutions of similar asset size to CFC, and did not review or consider underlying data pertaining to individual organizations comprising any of the survey groups. Instead, the CEO considered the aggregate compensation data to enhance his understanding of current practices in setting compensation at competitive levels.

Elements of Compensation

Base Pay – Our philosophy is to provide annual base pay that reflects the value of the job in the marketplace, targeted at the 50th percentile. To attract and retain a highly skilled work force, we must remain competitive with the pay of other employers that compete with us for talent.

After reviewing the performance of the organization and the evaluation of the CEO's performance by each board member, it was the assessment of the Committee that the CEO and the organization performed extremely well during another volatile business year. The Committee also took into consideration the information provided by Mercer Consulting, indicating that executive pay increases were projected to average about 3 percent for calendar year 2011. Therefore, in recognition of his strong performance and leadership, the Compensation Committee increased the CEO's base pay 3 percent to $813,700, effective January 1, 2012. In addition, in recognition of the CEO's successful leadership and strategic guidance of CFC through the recent down economy, the board of directors authorized a one-time cash award of $100,000 paid to the CEO in December 2011.

As discussed under Role of the Compensation Committee above, the CEO exercised his judgment to set the annual base pay for the other named executive officers based on general market data, overall performance and leadership accomplishments.

In recognition of Mr. Evans' expanding role and increased responsibilities as Executive Vice President and Chief Operating Officer, effective June 1, 2011, Mr. Evans' base salary, increased to $458,300, consistent with similar

positions in other organizations as determined through credible third party compensation sources.

In recognition of Mr. Larochelle's significant contributions and strategic leadership, as well as the success of corporate strategic initiatives he led or participated in, Mr. Larochelle's base salary was increased to $421,876 effective June 1, 2011.

Mr. List continues to perform well in his role as a senior leader of the organization. He contributed to the achievement of corporate strategies and objectives in a positive and meaningful way. It was determined that he is currently being paid an appropriate compensation package for an executive of this organization; therefore, in lieu of a base salary increase, he received a one-time cash award. The cash award amount is included in the total compensation table below.

Mr. Lilly also performed well in his role as a senior leader of the organization, contributing to the achievement of corporate strategies and objectives in a meaningful way. It was determined that he is also currently being paid an appropriate compensation package for an executive of this organization; therefore, in lieu of a base salary increase, he received a one-time cash award. The cash award amount is included in the total compensation table below.

Short-Term Incentive – Our short-term cash incentive program is a one-year cash incentive that is tied to the annual performance of the organization as a whole. We believe that by paying a short-term incentive tied to the achievement of annual operating goals, all employees, including named executive officers, will focus their efforts on the most important strategic objectives that will help us to fulfill our mission to our members and our obligations to the financial markets. Additionally, the short-term incentive pay enhances our ability to provide competitive compensation while at the same time tying total compensation paid to the achievement of corporate goals. Every employee participates in the short-term incentive program, and the corporate strategic goals are the same for all employees, including the named executive officers.

The short-term incentive program provides annual cash incentive opportunities based upon the level of the position within our base pay structure, ranging from 15 percent to 25 percent of base pay. Named executive officers are eligible to receive short-term cash incentive compensation up to 25 percent of their base pay. Since its inception in 1999, the actual payout percentage has ranged from 55 percent to 100 percent of total opportunity, with an average over the 14 years of 81.47 percent. This equates to a 14-year average payout of 15.66 percent of base salaries for all employees.

Our approach to establishing corporate goals for short-term incentive compensation has not changed since the plan's inception. Corporate performance is measured using a balanced scorecard approved by the board of directors prior to the start of the fiscal year. The balanced scorecard is a performance management tool that articulates the corporate strategy into specific, quantifiable, measurable goals. The goals have always been tied to enhancing service to our member owners while ensuring all aspects of the business are effectively managed.

The scorecard is divided into four quadrants, reflecting crucial areas of business performance. Specific goals are established within those quadrants to focus all employees on the target results and measures that must be achieved if we are to succeed at realizing our strategic plan. The intent is to align organizational, departmental and individual initiatives to achieve a common set of goals.

The four quadrants for fiscal year 2012, which were the basis for the short-term incentive payment, are the same as they have been in previous years: Customer Engagement, Financial Ratios, Internal Process and Operations, and Learning, Growth and Innovation. For fiscal year 2012, the board of directors established five corporate goals within these four quadrants. The board of directors establishes corporate goals and measures that they believe are challenging but achievable if each individual performs well in his or her role and we meet our internal business plan goals.

The goals for fiscal year 2012 were:

- Customer Engagement/ Learning, Growth & Innovation: Two goals supporting efforts to maintain or increase market share of borrowers in key segments of the loan portfolio.
- Internal Process and Operations: Manage CFC's operating expense levels.
- Financial Ratios: Two goals supporting efforts to meet or exceed established financial targets to maintain CFC's financial strength.

The determination of the extent to which the five goals were achieved and, therefore, the amount to be paid out under the short-term incentive plan for fiscal year 2012 was confirmed by the board of directors with the filing of this Form 10-K. The board determined that three of the goals were achieved, equating to 60 percent of the total opportunity.

Long-Term Incentive – The long-term incentive program is a three-year plan that is tied to CFC's long-term strategic objectives. The long-term incentive program was implemented to create dynamic tension between short-term objectives and long-term goals. It is also an effective retention tool, helping us to keep key employees, and supports CFC's efforts to compensate its employees at market competitive levels.

All employees employed on the first day of the fiscal year, June 1, are eligible to participate in the program for the performance period beginning on that date. Under the long-term incentive program, performance units covering a three-year performance period are issued to each employee at the start of each fiscal year. The long-term incentive is paid out in one lump sum after the end of the performance period, subject to approval by the board of directors and the continued employment of the participant by CFC on the date of payment. We sometimes refer to each three-year performance period as a program cycle.

The performance measure for all active long-term incentive plans is the achievement of bond rating targets for our senior secured debt as rated by Standard & Poor's Corporation and Moody's Investors Service rating agencies. The value of the performance units will range from $0 to $150 per performance unit according to the level of CFC's secured debt ratings by the rating agencies. To achieve the highest value of $150, which exceeds the targeted value, both agencies would have to raise CFC's long-term secured debt rating to AA (or the equivalent rating at Moody's). To determine the payout value of performance units, the ratings are given a numerical value, i.e., 2 for A+ stable, 3 for A+ positive, etc. The ratings are then averaged to achieve the final value of the performance units.

The number of performance units awarded to each employee for each program cycle is calculated by dividing a percentage, ranging from 15 percent to 25 percent, of the participant's base pay on the first day of the program cycle, by the payout value assigned to the target rating level. For the program cycle ending May 31, 2012, the target rating level was "AA-Stable", which was assigned a payout value of $100 per performance unit. For the named executive officers, the number of performance units awarded for that program cycle was based on 25 percent of each named executive officer's base pay on June 1, 2009. If the highest rating level was achieved at the end of that program cycle, resulting in payout of $150 per performance unit, the long-term incentive pay for named executive officers would have been 37.5 percent of 2009 base pay.

The following table shows the potential payout values for performance units awarded for the program cycle that ended May 31, 2012:

Senior Secured Debt Rating—Incentive-Performance Linkage

Rating		A+			AA-		AA
Outlook	negative	stable	positive	negative	stable	positive	
Numerical Score	1	2	3	4	5	6	
Plan Pay-Out Unit Value	$0	$20	$60	$60	$100	$120	$150

* The target objective is in bold.

CFC uses our senior secured debt rating as the performance measure for the long-term incentive plan because, as a financial services company, CFC is dependent on the capital markets and stronger ratings lead to lower interest cost and more reliable access to the capital markets. Since we have no publicly held equity securities and our objective is to offer our members low-cost financial products and services consistent with sound financial management rather than to maximize net income, more traditional performance measures such as net income or earnings per share would not be appropriate.

As of May 31, 2012, there were three active long-term incentive plans in which named executive officers are participants. Performance units issued to named executive officers in June 2009 had a payout value based on our senior secured debt ratings in place on May 31, 2012; performance units issued to named executive officers in June 2010 will have a payout value based on senior secured debt ratings in place on May 31, 2013; and performance units issued to named executive officers in June 2011 will have a payout value based on senior secured debt ratings in place on May 31, 2014. Payments made to named executive officers for fiscal year 2012 were for performance units issued in June 2009 and were based on the May 31, 2012 senior secured debt rating level of A+ stable outlook, which has a value of $20 per performance unit, or 20 percent of the targeted opportunity (5 percent of June 2009 base pay).

All current plans will pay out if both rating agencies, Standard & Poor's Corporation and Moody's Investors Services, rate our senior secured debt at a high enough level to receive a payout. The payout will be based on the average of the two ratings (averages are calculated and rounded down to the next whole number).

Risk Assessment
The Compensation Committee conducts an annual risk assessment of the Company's compensation policies and practices, particularly the short-term and long-term incentive plan goals, to ensure that the policies and practices do not encourage excessive risk. The Compensation Committee concluded that our compensation policies and practices are not reasonably likely to provide incentives for behavior that could have a material adverse effect on the Company.

Benefits

An important retention tool is our defined benefit pension plan, the Retirement Security Plan. CFC participates in a multiple employer pension plan managed by NRECA. We balance the effectiveness of this plan as a compensation and retention tool with the cost of the annual premium incurred to participate in this pension plan. The value of the pension benefit is determined by base pay only and does not include other cash compensation.

We also offer a Pension Restoration Plan, which is a component of the NRECA Retirement Security Plan, to a select group of management, including the named executive officers, to increase their retirement benefits above amounts available under the Retirement Security Plan, which is restricted by IRS limitations on annual pay levels and maximum annual annuity benefits. The Pension Restoration Plan restores the value of the Retirement Security Plan for named executive officers to the level it would be if the IRS limits on annual pay and annual annuity benefits were not in place. Unlike the Retirement Security Plan, the Pension Restoration Plan is an unfunded, unsecured obligation of CFC and is not qualified for tax purposes. We pay the

amount owed to the named executive officers for the pension restoration benefit; amounts paid are then deducted from the premium due for the next Retirement Security Plan invoice(s) from NRECA.

For more information on the Retirement Security Plan and the Pension Restoration Plan, see the Pension Benefits Table and accompanying narrative below.

As an additional retention tool designed to assist named executive officers in deferring compensation for use in retirement, each named executive officer is also eligible to participate in CFC's non-qualified 457(b) deferred compensation savings plan. Contributions to the plan are limited by IRS regulations. The calendar year 2012 cap for contributions is $17,000. There is no CFC contribution to the deferred compensation plan. For more information see Nonqualified Deferred Compensation below.

Other Compensation
We provide named executive officers with other benefits, as reflected in the All Other Compensation column in the Summary Compensation Table below, that we believe are reasonable and consistent with our compensation philosophy. We do not provide significant perquisites or personal benefits to the named executive officers.

The Compensation Committee considers perquisites for the CEO in connection with its annual review of the CEO's total compensation package described above. The perquisites provided to Mr. Petersen are limited to an annual automobile allowance as well as an annual spousal air travel allowance to permit Mr. Petersen's spouse to accompany him on business travel. To provide these perquisites in an efficient fashion, the board of directors authorizes an annual allowance rather than providing unlimited reimbursement or use of a company-owned vehicle. The amount of each allowance is authorized annually by the board of directors and is determined based on the estimated cost for operation and maintenance of an automobile and the anticipated cost of air travel by the CEO's spouse. For 2012, the board of directors authorized an aggregate of $30,000 to cover these allowances.

Severance/Change in Control Agreements
Mr. Petersen, Chief Executive Officer, and Mr. Evans, Executive Vice President and Chief Operating Officer, each have an executive agreement with CFC under which they may continue to receive compensation and benefits in certain circumstances after resignation or termination of employment. The value of Mr. Petersen's severance package was determined to be appropriate for a CEO and approved by the Compensation Committee as part of his employment contract. The value of Mr. Evans' severance package was negotiated by the CEO and Mr. Evans as part of Mr. Evans' employment offer. No other named executive officers have termination or change in control agreements. For more information on these severance arrangements, see Termination of Employment and Change in Control Arrangements below.

Compensation Committee Report
The Compensation Committee of the board of directors oversees CFC's compensation program on behalf of the board. In fulfilling its oversight responsibilities, the Compensation Committee reviewed and discussed with management the Compensation Discussion and Analysis set forth in this Form 10-K. Based on this review and discussion, the Compensation Committee recommended to the board of directors that the Compensation Discussion and Analysis be included in this Form 10-K.

Submitted by the Compensation Committee
Burns Mercer
Delbert Cranford
Joel Cunningham
Ray Beavers
Lyle Korver

Scott Handy
Glenn Miller

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Summary Compensation Table

The summary compensation table below sets forth the aggregate compensation for the years ended May 31, 2012, 2011 and 2010 earned by the named executive officers and three additional executive officers of CFC that meet the definition of “related persons” pursuant to SEC disclosure requirements.

Name and Principal Position	Year	Salary	Bonus (1)	Non-Equity Incentive Plan Compensation (2)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (3)	All Other Compensation (4)	Total
Sheldon C. Petersen	2012	$799,874	$ 100,000	$ 156,721	$ 896,555	$ 41,997	$1,995,147
Chief Executive Officer	2011	775,329		229,332	540,169	34,025	1,578,855
	2010	747,350		158,812	447,698	111,361	1,465,221
John T. Evans	2012	458,300	-	88,625	260,220	9,104	816,249
Executive Vice President	2011	433,800		128,330	206,602	5,994	774,726
& Chief Operating Officer	2010	397,700		84,511	202,007	14,998	699,216
Steven L. Lilly	2012	405,650	10,000	80,727	326,923	-	823,300
Senior Vice President &	2011	405,650		121,292	276,510	-	803,452
Chief Financial Officer	2010	397,700		84,511	272,443	7,648	762,302
John J. List	2012	405,650	15,000	80,727	163,754	4,900	670,031
Senior Vice President of	2011	405,650		121,292	35,705	5,759	568,406
Member Services and General Counsel	2010	397,700		84,511	116,312	14,424	612,947
Richard E. Larochelle	2012	421,876	-	83,161	628,834	5,035	1,138,906
Senior Vice President of	2011	405,650		121,292	347,103	5,759	879,804
Corporate Relations	2010	397,700		84,511	287,531	14,998	784,740
Lawrence Zawalick (4)	2012	312,000	-	61,300	498,172	7,037	878,509
Senior Vice President of	2011	295,600		88,400	175,814	5,687	565,501
Affiliate Organizations	2010	289,800		61,583	118,546	12,923	482,852
Andrew Don (4) (5)	2012	325,000	-	58,890	206,202	9,317	599,409
Senior Vice President & Treasurer	2011	261,050		74,863	75,574	5,839	417,326
John M. Borak (4)	2012	260,049	8,000	51,747	68,023	4,900	392,719
Senior Vice President of	2011	260,049		77,752	65,820	5,514	409,135
Credit Risk Management	2010	254,950		54,177	77,120	12,253	398,500

Name	Year	Short-term Incentive Plan	Long-term Incentive Plan
Sheldon C. Petersen	2012	$ 119,981	$ 36,740
	2011	193,832	35,500
	2010	158,812	-
John T. Evans	2012	68,745	19,880
	2011	108,450	19,880
	2010	84,511	-
Steven L. Lilly	2012	60,847	19,880
	2011	101,412	19,880
	2010	84,511	-
John J. List	2012	60,847	19,880
	2011	101,412	19,880
	2010	84,511	-
Richard E. Larochelle	2012	63,281	19,880
	2011	101,412	19,880
	2010	84,511	-
Lawrence Zawalick (5)	2012	46,800	14,500
	2011	73,900	14,500
	2010	61,583	-
Andrew Don (5) (6)	2012	48,750	10,140
	2011	65,263	9,600
John M. Borak (5)	2012	39,007	12,740
	2011	65,012	12,740
	2010	54,177	-

(1) Includes amounts given as one-time cash awards in lieu of base pay increases, except for Mr. Petersen, which was a bonus in addition to a base pay increase.
(2) Includes amounts earned during each respective fiscal year and payable at May 31 under the long-term and short-term incentive plans. For a discussion of the long-term and short-term incentive plans, see "Elements of Compensation" in Compensation Discussion and Analysis above. The amounts earned by each named executive officer under these incentive plans are as follows:
(3) Represents solely the aggregate change in the actuarial present value of the accumulated pension benefit under NRECA Retirement Security Plan, the multiple employer defined benefit pension plan in which CFC participates, during each respective fiscal year.
(4) For Mr. Petersen, includes $30,000 of perquisites comprising Mr. Petersen's automobile allowance and his spousal air travel allowance, in each case for fiscal year 2012. The annual automobile allowance is calculated based on estimated costs associated with maintenance, use and insurance of a personal automobile. The annual spousal travel allowance is calculated based on the anticipated air travel for Mrs. Petersen during the fiscal year. The remaining amounts included in this column represent CFC contributions on behalf of each named executive officer pursuant to the CFC 401(k) defined contribution plan, and contributions to health savings.
(5) These executives are "related persons" as defined by the SEC's disclosure requirements and are included in the Summary Compensation Table as we generally treat all of our executive officers equally.
(6) Andrew Don became an executive officer of CFC on June 1, 2010 when he was appointed Senior Vice President and Treasurer.

Grants of Plan-Based Awards
We have a long-term and a short-term incentive plan for all employees, under which the named executive officers may receive a cash incentive up to 37.5 percent and 25 percent of salary, respectively. The incentive payouts are based on the executive officer's salary at the date the program becomes effective. See the Compensation Discussion and Analysis above for further information on these incentive plans.

The following table contains the estimated possible payouts under our short-term incentive plan and possible future payouts for grants issued under our long-term incentive plan during the year ended May 31, 2012.

	Estimated Future Payouts Under Non-Equity Incentive Plan Awards		
	Threshold	Target	Maximum
Sheldon C. Petersen			
Long-term Incentive Plan (1)	$ -	$197,500	$ 296,250
Short-term Incentive Plan (2)	-	119,981	119,981
John T. Evans			
Long-term Incentive Plan (1)	-	114,600	171,900
Short-term Incentive Plan (2)	-	68,745	68,745
Steven L. Lilly			
Long-term Incentive Plan (1)	-	101,400	152,100
Short-term Incentive Plan (2)	-	60,847	60,847
John J. List			
Long-term Incentive Plan (1)	-	101,400	152,100
Short-term Incentive Plan (2)	-	60,847	60,847
Richard E. Larochelle			
Long-term Incentive Plan (1)	-	105,500	158,250
Short-term Incentive Plan (2)	-	63,281	63,281
Lawrence Zawalick			
Long-term Incentive Plan (1)	-	78,000	117,000

Short-term Incentive Plan (2)	-	46,800	46,800
Andrew Don			
Long-term Incentive Plan (1)	-	81,300	121,950
Short-term Incentive Plan (2)	-	48,750	48,750
John M. Borak			
Long-term Incentive Plan (1)	-	65,000	97,500
Short-term Incentive Plan (2)	-	39,007	39,007

(1) Target payouts are calculated using unit values of $100 based on our goal of achieving an average long-term senior secured credit rating of AA- stable at May 31, 2014.
(2) Target and maximum payouts represent 25 percent of May 31, 2012 base salary. For the payout earned under the fiscal year 2012 short-term incentive plan, see the Non-Equity Incentive Plan Compensation column of the Summary Compensation Table above.

The board of directors approved a new long-term incentive plan and made grants of performance units to the named executive officers in June 1, 2012. The payout under these grants will be determined on May 31, 2015.

Employment Contracts
Pursuant to an employment agreement effective as of January 1, 2008 and amended September 1, 2011, CFC has agreed to employ Mr. Petersen as Chief Executive Officer through February 28, 2015, unless otherwise terminated in accordance with the terms of the Agreement. The amended Agreement provides that CFC shall pay Mr. Petersen a base salary at an annual rate of not less than $790,000 per annum, plus such incentive payments (if any) as may be awarded him. In addition, pursuant to the Agreement, Mr. Petersen is entitled to certain payments in the event of his termination other than for cause (e.g., Mr.

Petersen leaving for good reason, disability or termination due to death). See Termination of Employment and Change in Control Arrangements below for a description of these provisions and for information on these amounts.

For information about Mr. Evans' termination agreement, see Termination of Employment and Change in Control Arrangements.

Pension Benefits Table

CFC is a participant in a multiple employer defined benefit pension plan, the Retirement Security Plan, which is administered by NRECA. Since the plan is a multiple employer plan in which CFC participates, CFC is not liable for the amounts shown in the table below and such amounts are not reflected in CFC's audited financial statements. CFC's expense is limited to the annual premium to participate in the plan. There is no funding liability for CFC for the plan.

The Retirement Security Plan is a qualified plan in which all employees are eligible to participate upon completion of one year of service. Each of the named executive officers participates in the qualified pension plan component of the Retirement Security Plan. CFC reduced the value of the pension plan effective September 1, 2010. Under the current pension plan, participants are entitled to receive annually, under a 50 percent joint and surviving spouse annuity, 1.70 percent of the average of their five highest base salaries during their last 10 years of employment, multiplied by the number of years of participation in the plan. The value of the pension benefit is determined by base pay only and does not include other cash compensation. Normal retirement age under the qualified pension plan is age 65; however, the plan does allow for early retirement with reduced benefits. For early retirement, the pension benefit will be reduced by 1/15 for each of the first five years and 1/30 for each of the next five years by which the elected early retirement date precedes the normal retirement date. Each of the named executive officers is eligible for early retirement under the plan. Benefits accrued prior to September 1, 2010, are based on a benefit level of 1.9 percent of the average of their five highest base salaries during their last 10 years of employment and a normal retirement age of 62.

CFC also offers a Pension Restoration Plan, which is a component of the Retirement Security Plan. Each of the named executive officers participates in the Pension Restoration Plan component of the Retirement Security Plan, the purpose of which is to increase their retirement benefits above amounts available under the Retirement Security Plan, which is restricted by IRS limitations on annual pay levels and maximum annual annuity benefits. The Pension Restoration Plan restores the value of the Retirement Security Plan for each officer to the level it would be if the IRS limits on annual pay and annual annuity benefits were not in place.

The benefit and payout formula under this restoration component of the Retirement Security Plan is similar to that under the qualified plan component. However, each of the named executive officers has satisfied the provisions established to receive the benefit from this plan. Since there is no longer a risk of forfeiture of the benefit under the Pension Restoration Plan, distributions will be made from the plan to each named executive officer annually.

The following table contains the years of service, the present value of the accumulated benefit for the executive officers listed in the Summary Compensation Table at May 31, 2012 and distributions from the plan for the fiscal year then ended.

Name	Plan Name	Number of Years Credited Service (1)	Present Value of Accumulated Benefit (2)	Payments During Last Fiscal Year (3)
Sheldon C. Petersen	NRECA Retirement Security Plan	28.75	$ 2,577,887	$ 362,324
John T. Evans	NRECA Retirement Security Plan	13.50	1,138,977	77,910

Steven L. Lilly (4)	NRECA Retirement Security Plan	1.75	110,326	1,545,980
John J. List (5)	NRECA Retirement Security Plan	3.92	107,511	101,493
Richard E. Larochelle	NRECA Retirement Security Plan	28.00	2,131,753	187,791
Lawrence Zawalick	NRECA Retirement Security Plan	31.67	1,946,648	88,694
Andrew Don	NRECA Retirement Security Plan	11.67	587,726	-
John M. Borak (6)	NRECA Retirement Security Plan	5.92	387,110	4,783

(1) CFC is a participant in a multiple employer pension plan. Credited years of service, therefore, includes not only years of service with CFC, but also years of service with another cooperative participant in the multiple employer pension plan. Mr. Larochelle has 13 credited years of service with another cooperative in addition to CFC. All other executives have credited years of service only with CFC.

(2) Amount represents the actuarial present value of the executive officer's accumulated benefit under the plan as of May 31, 2012, as
provided by the plan administrator, NRECA, using interest rates ranging from 1.25 percent to 5.26 percent per annum and mortality according to tables prescribed by the IRS as published in Revenue Rulings 2001-62 and 2007-67.

(3) Distributions during fiscal year 2012 were as a result of executive officers no longer being at risk of forfeiture with respect to these amounts provided under the deferred compensation restoration component of the Retirement Security Plan.

(4) Due to Mr. Lilly's quasi-retirement in January 2012 for benefit earned through August 2010, his credited years of service were reduced to reflect credited years of service from September 2010 to May 2012.

(5) Due to Mr. List's quasi-retirement in January 2009, his credited years of service were reduced to zero at that time. Subsequent to the quasi-retirement, Mr. List received credited years of service for the remainder of the 2009 calendar year and receives 12 months of credited service in January of each year thereafter.

(6) At May 31, 2012, Mr. Borak is eligible for retirement based on the normal retirement age of 65. Due to Mr. Borak's quasi-retirement in January 2007, his credited years of service were reduced to zero at that time. Subsequent to the quasi-retirement, Mr. Borak received credited years of service for the remainder of the 2007 calendar year and receives 12 months of credited service in January of each year thereafter.

Nonqualified Deferred Compensation

The CFC deferred compensation plan is a nonqualified deferred compensation savings program for the senior executive group, including each of the named executive officers, and other selected management or highly compensated employees designated by CFC. Participants may elect to defer up to the lesser of 100 percent of their compensation for the year or the applicable IRS statutory dollar limit in effect for that calendar year. The calendar year 2012 cap for contributions is $17,000. Compensation for the purpose of this plan is defined as the total amount of compensation, including incentive pay, if any, paid by CFC. CFC does not make any contributions to the plan.

The accounts are credited with "earnings" based on the participants' selection of available investment options (currently, eight options) within the Homestead Funds. When a participant ceases to be an employee for any reason, distribution of the account will generally be made in 15 substantially equal annual payments beginning approximately 60 days after termination (unless an election is made to change the form and timing of the payout). The participant may elect either a single lump sum or substantially equal annual installments paid over no less than two and no more than 14 years. The amount paid is based on the accumulated value of the account.

The following table summarizes information related to the nonqualified deferred compensation plan in which the executive officers listed in the Summary Compensation Table were eligible to participate during the year ended May 31, 2012.

Name	Executive Contributions in Last Fiscal Year (1)	Registrant Contributions in Last Fiscal Year	Aggregate Earnings in Last Fiscal Year	Aggregate Withdrawals/ Distributions	Aggregate Balance at Last Fiscal Year End
Sheldon C. Petersen	$ 17,000	$ -	$ (39,989)	$ -	$ 316,613
John T. Evans	16,500	-	(7,176)	-	198,754
Steven L. Lilly	-	-	(1,409)	-	197,652
John J. List	16,125	-	(6,349)	-	137,148
Richard E. Larochelle	17,125	-	6,009	-	271,911
Lawrence Zawalick	15,500	-	(13,810)	-	169,479
Andrew Don	-	-	-	-	-
John M. Borak	16,708	-	(2,759)	-	126,634

(1) Executive contributions are also included in the fiscal year 2012 Salary column in the Summary Compensation Table above.

Termination of Employment and Change in Control Arrangements

Mr. Petersen and Mr. Evans each have an executive agreement with CFC under which each such officer may continue to receive base salary and benefits in certain circumstances after resignation or termination of employment. No other named executive officers have termination or change in control agreements.

Mr. Petersen
Under the executive agreement with Mr. Petersen, if CFC terminates his employment without "cause," or Mr. Petersen terminates his employment for "good reason" (each term as defined below), CFC is obligated to pay him a lump sum payment equal to the product of three times his annual base salary at the rate in effect at the time of termination and his short-term incentive bonus, if any, for the previous year (or an amount equal to the short-term incentive bonus for fiscal year 2007). Assuming a triggering event of May 31, 2012, the compensation payable to Mr. Petersen for termination without cause would be $3,022,596. The actual payments due on a termination without cause on different dates could materially differ from this estimate.

For purposes of Mr. Petersen's executive agreement, "cause" generally means (i) the willful and continued failure by Mr. Petersen to perform his duties under the agreement or comply with written policies of CFC, (ii) willful conduct materially injurious to CFC or (iii) conviction of a felony involving moral turpitude. "Good reason" generally means (i) a reduction in the rate of Mr. Petersen's base salary, (ii) a decrease in his titles, duties or responsibilities, or the assignment of new responsibilities which, in either case, is materially less favorable to Mr. Petersen when compared with his titles, duties and responsibilities which were in effect immediately prior to such assignment or (iii) the relocation of CFC's principal office or the relocation of Mr. Petersen to a location more than 50 miles from the principal office of CFC.

Mr. Evans
Under the executive agreement with Mr. Evans, if CFC terminates his employment without cause, Mr. Evans would receive continued annual base salary in effect at the time of termination, incentive compensation, and payment for all health and welfare and retirement plans for an additional nine-month period. Assuming a termination date of May 31, 2012, the cost of compensation payable to Mr. Evans for termination without cause would be $475,783. The actual payments due for a termination without cause on different dates could materially differ from this estimate.

The estimates do not include amounts to which the named executive officers would be entitled to upon termination, such as base salary to date, unpaid bonuses earned, unreimbursed expenses, paid vacation time and any other earned benefits under company plans.

Director Compensation Table
Directors receive a fixed sum for each of the scheduled board meetings attended and for each conference call attended. Additionally, the directors receive reimbursement for reasonable travel expenses. The fixed cash amounts are paid following the conclusion of each board meeting or conference call attended. The following chart summarizes the total compensation earned by CFC's directors during the year ended May 31, 2012.

Name	Total Fees Earned
Delbert Cranford	$ 50,850
Burns E. Mercer	46,800
Joel Cunningham	41,600
Fred Anderson	43,350
Ray Beavers	42,600
Fred Brog	41,250
Raphael A. Brumbeloe	42,150
Mike Campbell	9,150
R. Grant Clawson	41,100
Walter K. Crook	32,100
Jim L. Doerstler	43,200
Jimmy Ewing Jr.	42,600
Michael J. Guidry	28,050
Christopher Hamon	42,750
Scott W. Handy	41,400
William A. Kopacz	42,750
Lyle Korver	42,750
Glenn Miller	44,250
Curtis Nolan	31,800
Randy D. Renth	43,050
Dwight Rossow	42,600
R. Wayne Stratton	42,900
Kirk A. Thompson	41,100
J. David Wasson	41,350

Compensation Committee Interlocks and Insider Participation
During the year ended May 31, 2012, there were no compensation committee interlocks or insider participation related to executive compensation.

Item 12.

Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Inapplicable.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

Review and Approval of Transactions with Related Persons

Our board of directors has established a written policy governing related person transactions. The policy covers transactions with related persons such as our directors and executive officers and their immediate family members and entities, such as certain of our members, of which any of our directors or executive officers is an executive officer, director or employee or otherwise controls. Under this policy, a related person transaction is any transaction in which we are a participant involving in excess of $120,000 in which a related person had, has or will have a direct or indirect material interest, other than compensatory and expense reimbursement arrangements, transactions where the related person's interest arises only from the person's position as a director of another entity that is a party to the transaction, and transactions that are deemed to be related credits. Such related person transactions are subject to review and approval by the General Counsel, or in some cases, the

board of directors (excluding any interested Director), based on whether the transaction is fair and reasonable to CFC and consistent with the best interests of CFC.

Related credits are extensions of credit to, or for the benefit of, related persons and entities that are made on substantially the same terms as, and follow underwriting procedures that are no less stringent than, those prevailing at the time for comparable transactions generally offered by CFC. Related credits are not subject to the procedures for transactions with related persons because we were established for the very purpose of extending financing to our members. We, therefore, enter into loan and guarantee transactions with members of which our officers and directors are members, employees, executive officers or directors in the ordinary course of our business. All related credits are reviewed from time to time by our internal Corporate Credit Committee, which monitors our extensions of credit, and our independent third-party reviewer, which reviews our credit extension policies on an annual basis. All loans, including related credits, are approved in accordance with an internal credit approval matrix, with each level of risk or exposure potentially escalating the required approval from our lending staff to management, a credit committee or the board of directors. Related credits of $250,000 or less are generally approved by our lending staff or internal Corporate Credit Committee. Any related credit in excess of $250,000 requires approval by the full board of directors, except that any interested directors may not participate, directly or indirectly, in the deliberations or vote with respect to such approval and the CEO has the authority to approve emergency and certain other lines of credit. Notwithstanding the related person transaction policy, the CEO will extend such lines of credit in qualifying situations to a member of which a CFC director was a director or officer, provided that all such credits are underwritten in accordance with prevailing standards and terms. Such situations are typically weather related and must meet specific qualifying criteria. To ensure compliance with this policy, no related persons may be present in person or by teleconference while a related credit is being considered. Under no circumstances may we extend credit to a related person or any other person in the form of a personal loan.

Related Person Transactions
See the Summary Compensation Table in Item 11 for a description of compensation paid to Lawrence Zawalick, Andrew Don and John Borak, CFC's executive officers who are not named executive officers, but meet the definition of a "related person" as described above.

As a cooperative, CFC was established for the very purpose of extending financing to its members (from which our directors must be drawn). Loans and guarantees to member systems of which directors of CFC are members, employees, officers or directors are made in the ordinary course of CFC business on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other members and which do not involve more than normal risk of uncollectibility or present other unfavorable features. It is anticipated that, consistent with its loan and guarantee policies in effect from time to time, additional loans and guarantees will be made by CFC to member systems and trade and service organizations of which directors of CFC are members, employees, officers or directors. CFC has adopted a policy whereby substantially all extensions of credit to entities related to directors or their immediate family members are approved only by the disinterested directors.

Independence Determinations
The board of directors has determined the independence of each director based on a review by the full board. The Audit Committee is subject to the independence requirements of Rule 10A-3 under the Securities Exchange Act. To evaluate the independence of our directors, the board has voluntarily adopted categorical independence standards consistent with the New York Stock Exchange ("NYSE") standards. However, because we only list debt securities on the NYSE, we are not subject to most of the corporate governance listing standards of the NYSE, including the independence requirements.

No director is considered independent unless the board has affirmatively determined that he or she has no material relationship with CFC, either directly or as a partner, shareholder or officer of an organization that has a relationship

with CFC. Material relationships can include banking, legal, accounting, charitable and familial relationships, among others. In addition, a director is not considered independent if any of the following relationships existed:

(i) the director is, or has been within the last three years, an employee of CFC or an immediate family member is, or has been within the last three years, an executive officer of CFC;

(ii) the director has received, or has an immediate family member who has received, during any 12-month period within the last three years, more than $120,000 in direct compensation from CFC, other than director and committee fees and pension or other forms of deferred compensation for prior service (provided that such compensation is not contingent in any way on continued service);

(iii) (a) the director or an immediate family member is a current partner of a firm that is CFC's internal or external auditor; (b) the director is a current employee of such a firm; (c) the director has an immediate family member who is a current employee of such a firm and personally works on CFC's audit; or (d) the director or an immediate family member was within the last three years (but is no longer) a partner or employee of such a firm and personally worked on CFC's audit within that time;

(iv) the director or an immediate family member is, or has been within the last three years, employed as an executive officer of another company where any of CFC's present executive officers at the same time serves or served on that company's compensation committee; or
(v) the director is a current employee, or an immediate family member is a current executive officer, of a company that has made payments to, or received payments from, CFC for property or services in an amount which, in any of the last three fiscal years, exceeds the greater of $1 million, or 2 percent, of such other company's consolidated gross revenue.

The board of directors also reviewed directors' responses to a questionnaire asking about their relationships with CFC and its affiliates (and those of their immediate family members) and other potential conflicts of interest.

Based on the criteria above, the board of directors has determined that the directors listed below are independent for the period of time served by such directors during fiscal year 2012. The board determined that none of the directors listed below had any of the relationships listed in (i) - (v) above or any other material relationship that would compromise his or her independence.

	Independent Directors	
Ray Beavers	Walter K. Crook	Curtis Nolan
Fred Brog	Joel Cunningham	Randy D. Renth
Raphael A. Brumbeloe	Jim L. Doerstler	Dwight Rossow
Mike Campbell	Jimmy Ewing, Jr.	R. Wayne Stratton
R. Grant Clawson	Michael J. Guidry	David Wasson (1)
Delbert Cranford	Glenn W. Miller	

(1) This director served during the year ended May 31, 2012; however he was no longer a director at May 31, 2012.

Item 14. Principal Accounting Fees and Services.

The following table summarizes the aggregate professional fees for the audit of the financial statements for the years ended
May 31, 2012 and 2011 and fees for other services provided during that period by Deloitte & Touche, LLP.

	2012	2011
Audit fees (1)	$1,435,750	$1,418,000
Audit-related fees (2)	40,000	77,660
Tax fees (3)	126,147	256,227
All other fees (4)	16,500	16,500
Total	$1,618,397	$1,768,387

(1) Audit fees in 2012 and 2011 consist of fees for the audit of our consolidated financial statements, including RTFC and NCSC in accordance with the accounting standards governing variable interest entities, totaling $1,092,250 and $1,092,000, respectively, and fees for the preparation of the stand-alone financial statements for RTFC and NCSC totaling $160,000. Additionally, audit fees in 2012 and 2011 include comfort letter fees and consents related to debt issuances and compliance work required by the independent auditors.
(2) Audit-related fees include fees incurred in connection with the acquisition of Innovative Communication Corporation's assets as a result of bankruptcy proceedings.
(3) Tax fees consist of assistance with matters related to tax compliance and consulting.
(4) These fees relate to the audit of a trust serviced by CFC and legislative research fees.

CFC's Audit Committee is solely responsible for the nomination, approval, compensation, evaluation and discharge of the independent public accountants. The independent registered public accountants report directly to the Audit Committee, and the Audit Committee is responsible for the resolution of disagreements between management and the independent registered public accountants. Consistent with Securities and Exchange Commission requirements, the Audit Committee has adopted a policy to pre-approve all audit and permissible non-audit services provided by the independent registered public accountants provided such services do not impair the independent public accountant's independence. All fiscal 2012 and fiscal 2011 services were pre-approved by the Audit Committee. CFC's independent registered public accountants for the current fiscal year have been appointed by the Audit Committee.

PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) Documents filed as a part of this report.

1. Consolidated financial statements

Consolidated financial statements	Page
Report of Independent Registered Public Accounting Firm	94
Consolidated Balance Sheets	95
Consolidated Statements of Operations	97
Consolidated Statements of Changes in Equity	98
Consolidated Statements of Cash Flows	99
Notes to Consolidated Financial Statements	101

2. Financial statement schedules

All schedules are omitted because they are not required, are inapplicable or the information is included in the financial statements or notes thereto.

3. Exhibits

3.1	-	Articles of Incorporation. Incorporated by reference to Exhibit 3.1 to Registration Statement No. 2-46018, filed October 12, 1972.
3.2	-	Amended Bylaws as approved by the CFC Board of Directors and members on March 7, 2011. Incorporated by reference to Exhibit 3.2 to our Form 10-Q filed on April 13, 2011.
4.1	-	Form of Capital Term Certificate. Incorporated by reference to Exhibit 4.3 to Registration Statement No. 2-46018 filed October 12, 1972.
4.2	-	Indenture dated February 15, 1994, between the Registrant and U.S. Bank National Association, successor trustee. Incorporated by reference to Exhibit 4.2 to our Form 10-Q filed on October 15, 2007.
4.3	-	Indenture between CFC and Mellon Bank, N.A., as Trustee. Incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-3 filed on November 14, 1995 (Registration No. 33-64231).
4.4	-	Indenture between CFC and Chemical Bank, as Trustee. Incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-3ASR filed on November 24, 2008 (Registration No. 333-155631).
4.5	-	First Supplemental Indenture between CFC and Chemical Bank, as Trustee. Incorporated by reference to Exhibit 4.8 to Registration Statement on Form S-3 filed on October 1, 1990 (Registration No. 33-58445).
4.6	-	Indenture dated May 15, 2000, between the Registrant and Bank One Trust Company, National Association, as trustee. Incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-3

		filed on May 25, 2000 (Registration No. 333-37940).
4.7	-	First Supplemental Indenture dated March 12, 2007, between the Registrant and U.S. Bank National Association, as trustee. Incorporated by reference to Exhibit 4.2 to Registration Statement on Form S-3ASR filed on April 19, 2007 (Registration No. 333-142230).
4.8	-	Indenture dated October 25, 2007, between the Registrant and U.S. Bank National Association, as trustee. Incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-3ASR filed on October 26, 2007 (Registration No. 333-146960).
10.1	-	Plan Document for CFC's Deferred Compensation Program amended and restated July 1, 2003. Incorporated by reference to Exhibit 10.1 to our Form 10-K filed on August 24, 2005.*
10.2	-	Employment Contract between CFC and Sheldon C. Petersen, effective January 1, 2008. Incorporated by reference to Exhibit 10.2 to our Form 10-Q filed on January 11, 2008.*
10.3	-	First Amendment to Employment Contract between CFC and Sheldon C. Petersen, effective September 1, 2011.*
10.4	-	Employment Contract between CFC and John T. Evans, dated September 17, 1997 including termination of employment arrangement. Incorporated by reference to Exhibit 10.4 to our Form 10-K filed on August 27, 2007.*
10.5	-	Plan Document for CFC's Deferred Compensation Pension Restoration Plan dated January 1, 2005. Incorporated by reference to Exhibit 10.16 to our Form 10-K filed on August 17, 2009.*
10.6	-	Revolving Credit Agreement dated March 21, 2011 for $1,125,000,000 maturing on March 21, 2014. Incorporated by reference to Exhibit 4.3 to our Form 10-Q filed on April 13, 2011.
10.7	-	Revolving Credit Agreement dated March 16, 2007 for $1,125,000,000 maturing on March 16, 2012. Incorporated by reference to Exhibit 4.4 to our Form 10-Q filed on April 12, 2007.
10.8	-	Revolving Credit Agreement dated March 10, 2010 for $1,300,000,000 maturing on March 8, 2013. Incorporated by reference to Exhibit 4.5 to our Form 10-Q filed on April 14, 2010.
10.9	-	Revolving Credit Agreement dated October 21, 2011 for $884,875,000 expiring on October 21, 2015. Incorporated by reference to Exhibit 10.1 to our Form 10-Q filed on January 17, 2012.

10.10 - Revolving Credit Agreement dated October 21, 2011 for $834,875,000 expiring on October 21, 2016. Incorporated by reference to Exhibit 10.2 to our Form 10-Q filed on January 17, 2012.

10.11 - Bond Purchase Agreement between the Registrant, Federal Financing Bank and Rural Utilities Service dated June 14, 2005 for up to $1,000,000,000. Incorporated by reference to Exhibit 4.12 to our Form 10-K filed on August 24, 2005.

10.12 - Series A Bond Guarantee Agreement between the Registrant and the Rural Utilities Service dated June 14, 2005 for up to $1,000,000,000. Incorporated by reference to Exhibit 4.13 to our Form 10-K filed on August 24, 2005.

10.13 - Pledge Agreement dated June 14, 2005, between the Registrant, the Rural Utilities Service and U.S. Bank Trust National Association. Incorporated by reference to Exhibit 4.14 to our Form 10-K filed on August 24, 2005.

10.14 - Series A Future Advance Bond from the Registrant to the Federal Financing Bank dated June 14, 2005 for up to $1,000,000,000 maturing on July 15, 2028. Incorporated by reference to Exhibit 4.15 to our Form 10-K filed on August 24, 2005.

10.15 - Bond Purchase Agreement between the Registrant, Federal Financing Bank and Rural Utilities Service dated April 28, 2006 for up to $1,500,000,000. Incorporated by reference to Exhibit 4.11 to our Form 10-K filed on August 25, 2006.

10.16 - Series B Bond Guarantee Agreement between the Registrant and the Rural Utilities Service dated April 28, 2006 for up to $1,500,000,000. Incorporated by reference to Exhibit 4.12 to our Form 10-K filed on August 25, 2006.

10.17 - Pledge Agreement dated April 28, 2006, between the Registrant, the Rural Utilities Service and U.S. Bank Trust National Association. Incorporated by reference to Exhibit 4.13 to our Form 10-K filed on August 25, 2006.

10.18 - Series B Future Advance Bond from the Registrant to the Federal Financing Bank dated April 28, 2006 for up to $1,500,000,000 maturing on July 15, 2029. Incorporated by reference to Exhibit 4.14 to our Form 10-K filed on August 25, 2006.

10.19 - Bond Purchase Agreement between the Registrant, Federal Financing Bank and Rural Utilities Service dated September 19, 2008 for up to $500,000,000. Incorporated by reference to Exhibit 4.29 to our Form 10-Q filed on October 14, 2008.

10.20 - Series C Bond Guarantee Agreement between the Registrant and the Rural Utilities Service dated September 19, 2008 for up to $500,000,000. Incorporated by reference to Exhibit 4.30 to our Form 10-Q filed on October 14, 2008.

10.21 - Pledge Agreement dated September 19, 2008, between the Registrant, the Rural Utilities Service and U.S. Bank Trust National Association. Incorporated by reference to Exhibit 4.31 to our Form 10-Q filed on October 14, 2008.

10.22 - Series C Future Advance Bond from the Registrant to the Federal Financing Bank dated September 19, 2008 for up to $500,000,000 maturing on October 15, 2031. Incorporated by reference to Exhibit 4.32 to our Form 10-Q filed on October 14, 2008.

10.23 - Amendment No. 1 dated September 19, 2008 to the Pledge Agreement dated April 28, 2006, between the Registrant, the Rural Utilities Service and U.S. Bank Trust National Association. Incorporated by reference to Exhibit 4.33 to our Form 10-Q filed on October 14, 2008.

10.24 - Indenture for Clean Renewable Energy Bonds, Tax Credit Series 2008A dated January 1, 2008, between the Registrant and U.S. Bank Trust National Association. The Indenture has been omitted and will be furnished supplementally to the Securities and Exchange Commission upon request.

10.25 - Indenture for Clean Renewable Energy Bonds, Secured Tax Credit Series 2009A dated September 1, 2009 between the Registrant, U.S. Bank Trust National Association as trustee, and the Federal Agricultural Mortgage Corporation as guarantor. The Indenture has been omitted and will be furnished supplementally to the Securities and Exchange Commission upon request.

10.26 - Bond Purchase Agreement between the Registrant, Federal Financing Bank and Rural Utilities Service dated as of November 10, 2010 for up to $500,000,000. Incorporated by reference to Exhibit 4.1 to our Form 10-Q filed on January 14, 2011.

10.27 - Series D Bond Guarantee Agreement between the Registrant and the Rural Utilities Service dated as of November 10, 2010 for up to $500,000,000. Incorporated by reference to Exhibit 4.2 to our Form 10-Q filed on January 14, 2011.

10.28 - Pledge Agreement dated as of November 10, 2010, between the Registrant, the Rural Utilities Service and U.S. Bank Trust National Association. Incorporated by reference to Exhibit 4.3 to our Form 10-Q filed on January 14, 2011.

10.29 - Series D Future Advance Bond from the Registrant to the Federal Financing Bank dated as of November 10, 2010 for up to $500,000,000 maturing on October 15, 2033. Incorporated by reference to Exhibit 4.4 to our Form 10-Q filed on January 14, 2011.

10.30 - Master Sale and Servicing Agreement dated July 24, 2009, between the Registrant and Federal Agricultural Mortgage Corporation. Incorporated by reference to Exhibit 4.47 to our Form 10-K filed on August 17, 2009.

10.31 - Amended and Restated Master Note Purchase Agreement dated March 24, 2011 between the Registrant and Federal Agricultural Mortgage Corporation. Incorporated by reference to Exhibit 4.4 to our Form 10-Q filed on April 13, 2011.

10.32 - Amended, Restated and Consolidated Pledge Agreement dated March 24, 2011, between the Registrant, Federal Agricultural Mortgage Corporation and U.S. Bank Trust National Association. Incorporated by reference to Exhibit 4.5 to our Form 10-Q filed on April 13, 2011.
10.33 - First Supplemental Note Purchase Agreement dated March 24, 2011 for $3,900,000,000 between the Registrant and Federal Agricultural Mortgage Corporation. Incorporated by reference to Exhibit 4.6 to our Form 10-Q filed on April 13, 2011.
10.34 - Series E Bond Purchase Agreement between the Registrant, Federal Financing Bank and Rural Utilities Service dated as of December 1, 2011 for up to $499,000,000. Incorporated by reference to Exhibit 10.3 to our Form 10-Q filed on January 17, 2012.
10.35 - Series E Bond Guarantee Agreement between the Registrant and the Rural Utilities Service dated as of December 1, 2011 for up to $499,000,000. Incorporated by reference to Exhibit 10.4 to our Form 10-Q filed on January 17, 2012.
10.36 - Pledge Agreement dated as of December 1, 2011, between the Registrant, the Rural Utilities Service and U.S. Bank National Association. Incorporated by reference to Exhibit 10.5 to our Form 10-Q filed on January 17, 2012.
10.37 - Series E Future Advance Bond from the Registrant to the Federal Financing Bank dated as of December 1, 2011 for up to $499,000,000 maturing on October 15, 2034. Incorporated by reference to Exhibit 10.6 to our Form 10-Q filed on January 17, 2012.
10.38 - Construction agreement between CFC and Whiting-Turner Contracting Company dated August 26, 2009. Incorporated by reference to Exhibit 10.17 to our Form 10-K filed on August 30, 2010.
10.39 - First Amendment to construction agreement between CFC and Whiting-Turner Contracting Company executed on June 1, 2010. Exhibit F to the First Amendment to the construction agreement has been omitted and will be furnished supplementally to the Securities and Exchange Commission upon request. Incorporated by reference to Exhibit 10.18 to our Form 10-K filed on August 30, 2010.
- Registrant agrees to furnish to the Securities and Exchange Commission a copy of all other instruments defining the rights of holders of its long-term debt upon request.
12 - Computations of ratio of earnings to fixed charges.
23.1 - Consent of Deloitte & Touche LLP.
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 Annual Report on Form 10-K of National Rural Utilities Cooperative Finance Corporation for the year ended May 31, 2012, formatted in XBRL: (i) the Consolidated Statements of Operations, (ii) the Consolidated Balance Sheets, (iii) the Consolidated Statement of Changes in Equity, (iv) the Consolidated Statements of Cash Flows and (v) the Notes to Consolidated Financial Statements.

* Identifies a management contract or compensatory plan or arrangement.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, in the County of Loudoun, Commonwealth of Virginia, on the 15th day of August 2012.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

By: /s/ SHELDON C. PETERSEN
Sheldon C. Petersen
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Signature	Title	Date
/s/ SHELDON C. PETERSEN Sheldon C. Petersen	Chief Executive Officer	
/s/ STEVEN L. LILLY Steven L. Lilly	Senior Vice President and Chief Financial Officer	
/s/ ROBERT E. GEIER Robert E. Geier	Vice President and Controller	
/s/ DELBERT CRANFORD Delbert Cranford	President and Director	
/s/ BURNS E. MERCER Burns E. Mercer	Vice President and Director	
/s/ JOEL CUNNINGHAM Joel Cunningham	Secretary-Treasurer and Director	
/s/ FRED ANDERSON Fred Anderson	Director	August 15 , 2012
/s/ RAY BEAVERS Ray Beavers	Director	

/s/ FRED BROG Fred Brog	Director
/s/ RAPHAEL A. BRUMBELOE Raphael A. Brumbeloe	Director
/s/ MIKE CAMPBELL Mike Campbell	Director
/s/ R. GRANT CLAWSON R. Grant Clawson	Director
/s/ WALTER K. CROOK Walter K. Crook	Director
/s/ JIM L. DOERSTLER Jim L. Doerstler	Director

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/s/ JIMMY EWING, JR. Jimmy Ewing, Jr.	Director	
/s/ MICHAEL J. GUIDRY Michael J. Guidry	Director	
/s/ CHRISTOPHER L. HAMON Christopher L. Hamon	Director	
/s/ SCOTT W. HANDY Scott W. Handy	Director	
/s/ WILLIAM A. KOPACZ William A. Kopacz	Director	August 15, 2012
/s/ LYLE KORVER Lyle Korver	Director	
/s/ GLENN W. MILLER Glenn W. Miller	Director	
/s/ CURTIS NOLAN Curtis Nolan	Director	
/s/ RANDY D. RENTH Randy D. Renth	Director	
/s/ DWIGHT ROSSOW Dwight Rossow	Director	
/s/ R. WAYNE STRATTON R. Wayne Stratton	Director	
/s/ KIRK A. THOMPSON Kirk A. Thompson	Director	

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Members of
National Rural Utilities Cooperative Finance Corporation
Dulles, Virginia

We have audited the accompanying consolidated balance sheets of National Rural Utilities Cooperative Finance Corporation and subsidiaries (the "Company") as of May 31, 2012 and 2011, and the related consolidated statements of operations, changes in equity, and cash flows for each of the three years in the period ended May 31, 2012. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of National Rural Utilities Cooperative Finance Corporation and subsidiaries as of May 31, 2012 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended May 31, 2012, in conformity with accounting principles generally accepted in the United States of America.

/s/ DELOITTE & TOUCHE LLP

McLean, Virginia
August 15, 2012

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands)

A S S E T S

	May 31, 2012	May 31, 2011
Cash and cash equivalents	$ 191,167	$ 293,615
Restricted cash	7,694	7,690
Investments in equity securities	59,045	58,601
Loans to members	18,919,612	19,330,797
Less: Allowance for loan losses	(143,326)	(161,177)
Loans to members, net	18,776,286	19,169,620
Accrued interest and other receivables	185,827	201,122
Fixed assets, net	102,770	88,794
Debt service reserve funds	39,803	45,662
Debt issuance costs, net	43,515	41,714
Foreclosed assets, net	223,476	280,811
Derivative assets	296,036	343,760
Other assets	25,716	30,233
	$ 19,951,335	$ 20,561,622

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands)

L I A B I L I T I E S A N D E Q U I T Y

	May 31, 2012	2011
Short-term debt	$ 4,493,434	$ 5,842,924
Accrued interest payable	161,817	194,859
Long-term debt	12,151,967	11,293,249
Deferred income	26,131	17,719
Other liabilities	63,922	60,477
Derivative liabilities	654,125	477,433
Subordinated deferrable debt	186,440	186,440
Members' subordinated certificates:		
Membership subordinated certificates	646,279	646,161
Loan and guarantee subordinated certificates	678,115	756,801
Member capital securities	398,350	398,250
Total members' subordinated certificates	1,722,744	1,801,212
Commitments and contingencies		
CFC equity:		
Retained equity	473,964	665,765
Accumulated other comprehensive income	9,199	9,758
Total CFC equity	483,163	675,523
Noncontrolling interest	7,592	11,786
Total equity	490,755	687,309
	$ 19,951,335	$ 20,561,622

See accompanying notes.

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NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands)

	For the years ended May 31,		
	2012	2011	2010
Interest income	$ 960,961	$ 1,008,911	$ 1,043,635
Interest expense	(761,778)	(841,080)	(912,111)
Net interest income	199,183	167,831	131,524
Recovery of loan losses	18,108	83,010	30,415
Net interest income after recovery of loan losses	217,291	250,841	161,939
Non-interest income:			
Fee and other income	17,749	23,646	17,711
Settlement income	-	-	22,953
Derivative losses	(236,620)	(30,236)	(20,608)
Results of operations of foreclosed assets	(67,497)	(15,989)	(5,469)
Total non-interest income	(286,368)	(22,579)	14,587
Non-interest expense:			
Salaries and employee benefits	(39,364)	(42,856)	(39,113)
Other general and administrative expenses	(25,973)	(28,591)	(31,839)
(Provision for) recovery of guarantee liability	(726)	673	5,281
Loss on early extinguishment of debt	(15,525)	(3,928)	-
Other	(739)	(1,018)	(604)
Total non-interest expense	(82,327)	(75,720)	(66,275)
(Loss) income prior to income taxes	(151,404)	152,542	110,251
Income tax benefit (expense)	2,607	(1,327)	296
Net (loss) income	(148,797)	151,215	110,547
Less: Net loss (income) attributable to the noncontrolling interest	4,070	(1,789)	(235)

Net (loss) income attributable to CFC	$ (144,727)	$ 149,426	$ 110,312

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(in thousands)

	Total	Noncontrolling interest	Total CFC equity	Accumulated other comprehensive income	CFC retained equity	Unallocated net income (loss)	Members' capital reserve	Patronage capital allocated
Balance as of May 31, 2009	$ 519,100	$ 10,162	$ 508,938	$ 8,115	$ 500,823	$ (109,691)	$ 187,098	$ 420,834
Patronage capital retirement	(41,400)	-	(41,400)	-	(41,400)	-	-	(41,400)
Net income	110,547	235	110,312	-	110,312	2,707	4,895	101,686
Other comprehensive loss	(139)	(28)	(111)	(111)	-	-	-	-
Total comprehensive income	110,408	207	110,201					
Other	(1,341)	(183)	(1,158)	-	(1,158)	-	-	-
Balance as of May 31, 2010	$ 586,767	$ 10,186	$ 576,581	$ 8,004	$ 568,577	$ (106,984)	$ 191,993	$ 481,120
Patronage capital retirement	(51,396)	-	(51,396)	-	(51,396)	-	-	(51,396)
Net income	151,215	1,789	149,426	-	149,426	(23,705)	80,133	92,173
Other comprehensive income (loss)	1,726	(28)	1,754	1,754	-	-	-	-
Total comprehensive income	152,941	1,761	151,180					
Other	(1,003)	(161)	(842)	-	(842)	-	-	-
Balance as of May 31, 2011	$ 687,309	$ 11,786	$ 675,523	$ 9,758	$ 665,765	$ (130,689)	$ 272,126	$ 521,897
Patronage capital retirement	(46,265)	(44)	(46,221)	-	(46,221)	-	-	(46,221)
Net (loss) income	(148,797)	(4,070)	(144,727)	-	(144,727)	(216,252)	-	70,690
Other comprehensive loss	(584)	(25)	(559)	(559)	-	-	-	-
Total comprehensive	(149,381)	(4,095)	(145,286)					

loss								
Other	(908)	(55)	(853)	-	(853)	-	-	-
Balance as of May 31, 2012	$ 490,755	$ 7,592	$ 483,163	$ 9,199	$ 473,964	$ (346,941)	$ 272,126	$ 546,366

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	For the years ended May 31,		
	2012	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES			
Net (loss) income	$ (148,797)	$ 151,215	$ 110,547
Adjustments to reconcile net (loss) income to net cash provided by operating activities			
Amortization of deferred income	(10,409)	(9,079)	(7,687)
Amortization of debt issuance costs and deferred charges	10,897	16,298	13,011
Depreciation	4,324	2,231	1,984
(Recovery of) provision for loan losses	(18,108)	(83,010)	(30,415)
Provision for (recovery of) guarantee liability	726	(673)	(5,281)
Results of operations of foreclosed assets	67,497	15,989	5,469
Derivative forward value	223,774	23,388	(2,696)
Changes in operating assets and liabilities:			
Accrued interest and other receivables	26,164	19,058	30,032
Accrued interest payable	(33,042)	(19,213)	(35,530)
Other	(3,956)	6,393	4,386
Net cash provided by operating activities	119,070	122,597	83,820
CASH FLOWS FROM INVESTING ACTIVITIES			
Advances made on loans	(6,411,857)	(7,764,118)	(6,950,561)
Principal collected on loans	6,654,443	6,932,195	7,672,030
Net investment in fixed assets	(18,300)	(35,343)	(14,504)
Proceeds from foreclosed assets	39,566	44,884	1,000
Investments in foreclosed assets	(49,728)	(133,807)	-
Net proceeds from sale of loans	192,156	326,707	127,855
Investments in equity securities	-	(24)	(11,092)
Change in restricted cash	(4)	8,019	(7,502)
Net cash provided by (used in) investing activities	406,276	(621,487)	817,226

CASH FLOWS FROM FINANCING ACTIVITIES			
(Repayments) proceeds from issuances of short-term debt, net	(73,806)	1,026,140	5,957
Issuance costs for revolving bank lines of credit	(3,672)	(4,209)	(8,501)
Proceeds from issuance of long-term debt	2,081,533	2,412,703	1,714,521
Payments for retirement of long-term debt	(2,519,650)	(2,988,805)	(2,651,172)
Payments for retirement of subordinated deferrable debt	-	(125,000)	-
Proceeds from issuance of members' subordinated certificates	34,325	65,691	156,197
Payments for retirement of members' subordinated certificates	(102,115)	(59,824)	(69,701)
Payments for retirement of patronage capital	(44,409)	(48,097)	(39,440)
Net cash (used in) provided by financing activities	(627,794)	278,599	(892,139)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(102,448)	(220,291)	8,907
BEGINNING CASH AND CASH EQUIVALENTS	293,615	513,906	504,999
ENDING CASH AND CASH EQUIVALENTS	$ 191,167	$ 293,615	$ 513,906

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	For the years ended May 31,		
	2012	2011	2010
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION			
Cash paid for interest	$783,923	$843,995	$ 934,630
Cash paid for income taxes	293	1,329	306
Non-cash financing and investing activities:			
Subordinated certificates and other amounts applied against loan balances	$ 534	$ 318	$ 188
Patronage capital applied against loan balances	134	1,737	-
Noncontrolling interest patronage capital applied against loan balances	44	200	-
Fair value of foreclosed assets applied as repayment of loans	-	165,625	-
Charge-offs of allowance for loan losses applied against loan balances	-	354,248	-
Net decrease in debt service reserve funds/debt service reserve certificates	(5,859)	-	(1,000)

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) General Information and Accounting Policies

(a) General Information

National Rural Utilities Cooperative Finance Corporation ("CFC") is a member-owned cooperative association incorporated under the laws of the District of Columbia in April 1969. CFC's principal purpose is to provide its members with financing to supplement the loan programs of the Rural Utilities Service ("RUS") of the USDA. CFC makes loans to its rural electric members so they can acquire, construct and operate electric distribution, generation, transmission and related facilities. CFC also provides its members with credit enhancements in the form of letters of credit and guarantees of debt obligations. CFC is exempt from federal income taxes under Section 501(c)(4) of the Internal Revenue Code. As a member-owned cooperative lender, CFC's objective is to offer its members cost-based financial products and services consistent with sound financial management and is not to maximize net income.

Rural Telephone Finance Cooperative ("RTFC") is a cooperative association originally incorporated in South Dakota in 1987 and reincorporated as a member-owned cooperative association in the District of Columbia in 2005. RTFC's principal purpose is to provide and arrange financing for its rural telecommunications members and their affiliates. As a member-owned cooperative lender, RTFC's objective is to offer its members cost-based financial products and services consistent with sound financial management and is not to maximize net income. RTFC's membership consists of a combination of not-for-profit entities and for-profit entities. RTFC's results of operations and financial condition are consolidated with CFC in the accompanying financial statements. RTFC is headquartered with CFC in Dulles, Virginia. RTFC is a taxable cooperative that pays income tax based on its net income, excluding patronage-sourced net earnings allocated to its patrons, as permitted under Subchapter T of the Internal Revenue Code.

National Cooperative Services Corporation ("NCSC") was incorporated in 1981 in the District of Columbia as a member-owned cooperative association. NCSC's principal purpose is to provide financing to members of CFC, entities eligible to be members of CFC and the for-profit and non-profit entities that are owned, operated or controlled by or provide significant benefit to certain members of CFC. As a member-owned cooperative lender, NCSC's objective is to offer its members cost-based financial products and services consistent with sound financial management and is not to maximize net income. NCSC's membership consists of CFC and distribution systems that are members of CFC or are eligible for such membership. NCSC's results of operations and financial condition are consolidated with CFC in the accompanying financial statements. NCSC is headquartered with CFC in Dulles, Virginia. NCSC is a taxable cooperative that pays income tax on the full amount of its net income.

(b) Principles of Consolidation and Basis of Presentation

The accompanying financial statements include the consolidated accounts of CFC, RTFC and 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 controlled by CFC to hold foreclosed assets and to accommodate loan securitization transactions.

CFC established limited liability corporations and partnerships to hold foreclosed assets and facilitate loan securitization transactions. CFC owns and controls all of these entities and, therefore, consolidates their financial results. A full consolidation is presented for the entity formed for loan securitization transactions. CFC presents the

companies formed to hold foreclosed assets in one line on the consolidated balance sheets and the consolidated statements of operations. Foreclosed assets are held by two subsidiaries controlled by CFC. Denton Realty Partners, LP ("DRP") holds assets including a land development loan, limited partnership interests in certain real estate developments and developed lots and land, raw land and underground mineral rights in Texas. Caribbean Asset Holdings ("CAH") holds our investment in cable and telecommunications operating entities in the United States Virgin Islands ("USVI"), British Virgin Islands and St. Maarten.

Based on the accounting standards governing consolidations, affiliate equity controlled by RTFC and NCSC is classified as noncontrolling interest on the consolidated balance sheet, and the subsidiary earnings controlled by RTFC and NCSC is reported as net loss or net income attributable to the noncontrolling interest on the consolidated statement of operations.

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 lending activities of RTFC and NCSC. Under separate guarantee agreements, RTFC and NCSC pay CFC a fee to indemnify against loan losses. CFC is the sole lender to and manages the business operations of RTFC through a management agreement in effect until December 1, 2016. CFC is the primary source of funding to and manages the lending activities of NCSC through a management agreement that is automatically renewable on an annual basis unless terminated by either party. NCSC funds its lending programs through loans from CFC or debt guaranteed by CFC. In connection with these guarantees, NCSC must pay a guarantee fee and purchase from CFC interest-bearing subordinated term certificates in proportion to the related guarantee. NCSC discontinued the use of its commercial paper program effective September 1, 2011.

All loans that require RTFC board approval also require approval by CFC for funding under RTFC's credit facilities with CFC. CFC is not a member of RTFC and does not elect directors to the RTFC board. RTFC has a non-voting associate member relationship with CFC. RTFC members elect directors to the RTFC board based on one vote for each member. All loans that require NCSC board approval also require CFC board approval. CFC controls the nomination process for one of 11 NCSC directors. NCSC members elect directors to the NCSC board based on one vote for each member. NCSC is a service organization member of CFC.

RTFC and NCSC creditors have no recourse against CFC in the event of a default by RTFC and NCSC, unless there is a guarantee agreement under which CFC has guaranteed NCSC or RTFC debt obligations to a third party. At May 31, 2012, CFC had guaranteed $97 million of NCSC debt, derivative instruments and guarantees with third parties, and CFC's maximum potential exposure for these instruments totaled $107 million. The maturities for NCSC obligations guaranteed by CFC run through 2031. Guarantees of NCSC debt and derivative instruments are not included in Note 12, Guarantees, as the debt and derivatives are reported on the consolidated balance sheet. At May 31, 2012, CFC guaranteed $1 million of RTFC guarantees with third parties. The maturities for RTFC obligations guaranteed by CFC run through 2013. All CFC loans to RTFC and NCSC are secured by all assets and revenue of RTFC and NCSC. At May 31, 2012, RTFC had total assets of $689 million including loans outstanding to members of $572 million, and NCSC had total assets of $623 million including loans outstanding of $594 million. At May 31, 2012, CFC had committed to lend RTFC up to $4,000 million, of which $553 million was outstanding. At May 31, 2012, CFC had committed to provide up to $2,000 million of credit to NCSC, of which $672 million was outstanding, representing $575 million of outstanding loans and $97 million of credit enhancements.

At May 31, 2012, after taking into consideration systems that are members of both CFC and NCSC and eliminating memberships between CFC, RTFC and NCSC, our consolidated membership totaled 1,463 members and 261 associates. Our membership includes the following:

- 838 distribution systems;
- 71 power supply systems;
- 488 telecommunications members;
- 65 statewide and regional associations; and
- 1 national association of cooperatives.

Associates are eligible to borrow, however, they are not eligible to vote on matters submitted to the membership for approval. Our members and associates are located in 49 states, the District of Columbia and two U.S. territories. All references to members within this document include members and associates.

(c) Cash and Cash Equivalents

Cash, certificates of deposit and other investments with original maturities of less than 90 days are classified as cash and cash equivalents.

(d) Restricted Cash

Restricted cash represents cash and cash equivalents for which use is contractually restricted.

Restricted cash totaling $8 million at May 31, 2012 and 2011 related to Clean Renewable Energy Bonds ("CREBs") that were issued in February 2008 and October 2009 represent the following:

- Cash proceeds from the issuance of CREBs that may be used only for funding CREBs loan advances to participating members to reimburse them for costs related to construction, refinancing and reimbursement of capital expenditures related to qualifying renewable energy projects. We may invest these funds, and the interest earned on the invested cash is restricted as it may be used only to fund qualifying projects.
- Cash proceeds from the issuance of CREBs that may be used only to reimburse us for the costs of issuing the CREBs. These funds are held by the trustee and are only released to us to cover the costs of issuance, for which we must submit invoices for reimbursement. We may invest these funds, and the interest earned on the invested cash is restricted and may be used only to cover issuance expenses and to fund qualifying projects.
- Cash from principal payments from members on CREBs loans that may be used only to make debt service payments to bond investors. We collect principal and interest payments from borrowers quarterly. We may withdraw the interest collected on CREBs loans at any time. We may invest these funds, and the interest earned on the invested cash is not restricted and may be withdrawn at any time.

Interest earned on restricted cash accounts where use is contractually restricted is presented as an investing activity in the statement of cash flows. Interest earned on restricted cash accounts where use is not contractually restricted is presented as an operating activity in the statement of cash flows. Changes in the principal balances of restricted cash accounts are reported as investing activities in the statement of cash flows.

(e) Investments

We account for our investments in available-for-sale securities based on the accounting standards for debt and equity securities. Available-for-sale securities are carried at fair value. Unrealized holding gains and losses on these securities are recognized in accumulated other comprehensive income. Realized gains or losses are measured and reclassified from accumulated other comprehensive income into earnings when investments are sold or when an other-than-temporary impairment exists.

We account for our investments in preferred stock under the cost method based on applicable accounting standards as these investments do not meet the definition of a marketable security. Under the cost method of accounting, we record the preferred stock at cost and recognize any dividends earned from net accumulated earnings as interest income. Dividends received in excess of earnings after the date of investment are considered a return of investment and are recorded as reductions to the cost of the investment. We continually monitor these investments for possible impairment. Other-than-temporary impairments are recognized in earnings.

(f) Loans to Members

Loans to members are reported at historical cost based on their outstanding principal balances. Loan origination costs are deferred and amortized using the straight-line method, which approximates the effective interest method, over the life of the loan as a reduction to interest income.

(g) Unadvanced Loan Commitments

Unadvanced commitments represent amounts for which we have approved and executed loan contracts, but the funds have not been advanced. The majority of the unadvanced commitments reported represent amounts that are subject to material adverse change clauses at the time of the loan advance. Prior to making an advance on these facilities, we would confirm that there has been no material adverse change in the business or 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. The remaining unadvanced commitments relate 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.

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 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 multiple-year 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 reported will expire without being fully drawn upon and that the total commitment amount does not necessarily represent future cash funding requirements.

(h) Allowance for Credit Losses

Allowance for Loan Losses
We maintain an allowance for loan losses at a level estimated by management to provide for probable losses inherent in the loan portfolio. The allowance for loan losses is reported separately on the consolidated balance sheet, and the recovery from or provision for loan losses is reported as a separate line item on the consolidated statement of operations.

We review the estimates and assumptions used in the calculations of the loan loss allowance on a quarterly basis. The estimate of the allowance for loan losses is based on a review of the composition of the loan portfolio, past loss experience, specific problem loans, current economic conditions, available market data and/or projection of future cash flows and other pertinent factors that in management's judgment may contribute to expected losses. The allowance is based on estimates and, accordingly, actual losses may differ from the allowance amount. The methodology used to calculate the loan loss allowance is summarized below.

The loan loss allowance is calculated by dividing the portfolio into two categories of loans:
(1) the general portfolio, which comprises loans that are performing according to the contractual agreements; and
(2) the impaired portfolio, which comprises loans that (i) are not currently performing or (ii) for various reasons we do not expect to collect all amounts payable under the terms of the loan agreement or (iii) are performing according to a restructured loan agreement, but as a result of the troubled debt restructuring are required to be classified as impaired.

General Portfolio
The general portfolio of loans consists of all loans not specifically identified as impaired. We disaggregate the loans in the general portfolio by lender type: CFC, RTFC and NCSC. We further disaggregate the CFC loan portfolio by member class: distribution, power supply and statewide and associates.

We use the following factors to determine the loan loss allowance for the general portfolio category:
- Internal risk ratings system. We maintain risk ratings for our borrowers that are updated at least annually and are based on the following:
  - general financial condition of the borrower;
  - our estimate of the adequacy of the collateral securing our loans;
  - our judgment of the quality of the borrower's management;
  - our judgment of the borrower's competitive position within its service territory and industry;
  - our estimate of the potential impact of proposed regulation and litigation; and
  - other factors specific to individual borrowers or classes of borrowers.
- Standard & Poor's historical corporate bond default table. The table provides expected default rates for all corporate bonds based on rating level and the remaining maturity. We correlate our internal risk ratings to the ratings used in the corporate bond default table. We use the default table to assist in estimating our loan loss allowance because we have limited history from which to develop loss expectations.
- Recovery rates. Estimated recovery rates are based on our historical recovery experience by member class calculated by comparing loan balances at the time of default to the total loss recorded on the loan.

In addition to the loan loss allowance for the general portfolio based on the factors above, we maintain an unallocated reserve for the general portfolio. Our unallocated reserve has two components:

- A single-obligor reserve to cover the additional risk associated with large loan exposures. This unallocated reserve is based on our internal risk ratings and is based on exposures above an established threshold.
- An economic and environmental reserve to cover factors we believe are currently affecting the financial results of borrowers but are not reflected in our internal risk rating process and, therefore, present an increased risk of losses incurred as of the balance sheet date. We use annual audited financial statements from our borrowers as part of our internal risk rating process. There could be a lag between the time various environmental and economic factors occur and the time when these factors are reflected in the annual audited financial statements of the borrower and, therefore, the internal risk rating we determine for the borrower. Our Corporate Credit Committee makes a quarterly determination of the percentage to apply to loans in the general portfolio as an additional reserve. This reserve component may be set at up to 10 percent of the amount of the calculated general loan loss allowance for each type of loan exposure.

Impaired Loans

A loan is considered to be impaired when we do not expect to collect all principal and interest payments as scheduled by the original loan terms, other than an insignificant delay or an insignificant shortfall in amount. Factors considered in determining impairment may include, but are not limited to:

- the review of the borrower's audited financial statements and interim financial statements if available,
- the borrower's payment history,
- communication with the borrower,
- economic conditions in the borrower's service territory,
- pending legal action involving the borrower,
- restructure agreements between us and the borrower and
- estimates of the value of the borrower's assets that have been pledged as collateral to secure our loans.

An impairment loss on a loan receivable is recognized as the difference between the recorded investment in the loan and the present value of the estimated future cash flows associated with the loan discounted at the effective interest rate on the loan at the time of impairment. If the current balance in the receivable is greater than the net present value of the future payments discounted at the effective interest rate at the time the loans became impaired, the impairment is equal to that difference and a portion of the loan loss allowance is specifically reserved based on the calculated impairment. If cash flows cannot be estimated, the loan is collateral dependent or foreclosure is probable, the impairment is calculated based on the estimated fair value of the collateral securing the loan.

Our policy for recognizing interest income on impaired loans is determined on a case-by-case basis. An impaired loan to a borrower that is non-performing will typically be placed on non-accrual status and we will reverse all accrued and unpaid interest. We generally apply all cash received during the non-accrual period to the reduction of principal, thereby foregoing interest income recognition. Interest income may be recognized on an accrual basis for restructured impaired loans where the borrower is performing and is expected to continue to perform based on agreed-upon terms.

All loans are written off in the period that it becomes evident that collectability is highly unlikely; however, our efforts to recover all charged-off amounts may continue. The determination to write off all or a portion of a loan balance is made based on various factors on a case-by-case basis including, but not limited to, cash flow analysis and the fair value of collateral securing the borrower's loans.

Allowance for Unadvanced Loan Commitments

We do not maintain an allowance for the majority of our unadvanced loan commitments as the loans are generally subject to material adverse change clauses that would not require us to lend or continue to lend to a borrower experiencing a material adverse change in their business or condition, financial or otherwise. The methodology used to determine an estimate of probable losses for unadvanced commitments related to committed lines of credit that are not subject to a material adverse change clause at the time of each loan advance is consistent with the methodology used to determine the allowance for loan losses. Due to the nature of unadvanced commitments, the estimate of probable losses also considers the probability of funding such loans based on our historical average utilization rate for committed lines of credit. The allowance for unadvanced commitments is included in the other liabilities line item on the consolidated balance sheet. Changes to the allowance for unadvanced commitments are recorded in the consolidated statement of operations in other non-interest expense.

Guarantee Liability

We maintain a guarantee liability that represents our contingent and non-contingent exposure related to guarantees and standby liquidity obligations associated with our members' debt. The guarantee liability is included in the other liabilities line item on the consolidated balance sheet, and the provision for guarantee liability is reported in non-interest expense as a separate line item on the consolidated statement of operations.

The contingent portion of the guarantee liability represents management's estimate of our exposure to losses within the guarantee portfolio. The methodology used to estimate the contingent guarantee liability is consistent with the methodology used to determine the allowance for loan losses.

We record a non-contingent guarantee liability for all new or modified guarantees since January 1, 2003. Our non-contingent guarantee liability represents our 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. Our non-contingent obligation is estimated based on guarantee and liquidity fees charged for guarantees issued, which represents management's estimate of the fair value of our obligation to stand ready to perform. The fees are deferred and amortized using the straight-line method into interest income over the term of the guarantee.

(i) Non-performing Loans

We classify loans as non-performing when any one of the following criteria is met:

- principal or interest payments on any loan to the borrower are past due 90 days or more;
- as a result of court proceedings, repayment on the original terms is not anticipated; or
- for other reasons, management does not expect the timely repayment of principal and interest.

A loan is considered past due if a full payment of principal and interest is not received within 30 days of its due date. Once a borrower is classified as non-performing, we typically place the loan on non-accrual status and reverse any accrued and unpaid interest recorded during the period in which the borrower stopped performing. We generally apply all cash received during the non-accrual period to the reduction of principal, thereby foregoing interest income recognition. The decision to return a loan to accrual status is determined on a case-by-case basis.

(j) 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 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 years ended May 31, 2012, 2011 and 2010 we sold CFC loans with outstanding balances totaling $192 million, $327 million and $128 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 years ended May 31, 2012, 2011 and 2010.

During the years ended May 31, 2012, 2011, and 2010 we recognized $3 million, $2 million and $1 million, respectively, in servicing fees on all direct loan sale and loan securitization transactions.

(k) Fixed Assets

Fixed assets are recorded at cost less accumulated depreciation. Depreciation expense (approximately $4 million, $2 million and $2 million in fiscal years 2012, 2011 and 2010, respectively,) is computed on the straight-line method over estimated useful lives ranging from one to 40 years. Construction in progress for fiscal year 2011 primarily includes materials, labor, engineering, site development costs, interest and other costs relating to the construction and development of our new headquarters building, which is not depreciated until placed into service. Interest capitalized in connection with the construction of long-lived assets was not material for the years ended May 31, 2012, 2011 and 2010. Fixed assets consisted of the following as of May 31:

(dollar amounts in thousands)	2012	2011
Building and building equipment	$ 47,288	$ -
Furniture and fixtures	3,985	2,972
Computer software and hardware	24,336	20,685
Other	2,162	1,177
Less: accumulated depreciation	(15,035)	(13,926)
Land	38,608	36,770
Construction-in-progress and software	1,426	41,116

Fixed assets, net	$	102,770	$	88,794

(l) Debt Service Reserve Fund

At May 31, 2012 and 2011, we had $40 million and $46 million, respectively, pledged to the trustee for our members' obligations to repay tax-exempt bonds, for which we are the guarantor. The member cooperatives are required to purchase debt service reserve subordinated certificates as a condition to obtaining the guarantee. We are required to pledge the proceeds from the members' purchase of the debt service reserve subordinated certificates to the trustee.

A deficiency in the fund may occur when (i) the member does not pay the full amount of the periodic debt service payments as due to the trustee or (ii) upon maturity, the trustee uses the amount of the debt service reserve fund to reduce the final

payment required by the member. If there is a deficiency in the bond payment due from a member, the trustee will first use the pledged amounts in the related debt service reserve fund to make up the deficiency. If there is still a deficiency after the debt service reserve fund amount is used, then we are required to perform under our guarantee. The member cooperatives are required to make up any deficiency in their specific debt service reserve fund. We record a guarantee liability, which is based on the full amount of the tax-exempt bonds guaranteed. We do not have any additional liability specific to the debt service reserve fund as we have the right at any time to offset the member's investment in the debt service subordinated certificate against the amount that the member is required to pay to replenish the debt service reserve fund. There were no deficiencies in the debt service reserve fund at May 31, 2012 and 2011. Earnings on the debt service reserve fund inure to the benefit of the member cooperatives but are pledged to the trustee and used to reduce the periodic interest payments due from the member cooperatives.

During the year ended May 31, 2012, $4 million of guaranteed bonds requiring a debt service reserve fund were fully repaid, and no new guarantees requiring a debt service reserve fund were made. This resulted in a net reduction of $6 million to the debt service reserve fund and member investments in debt service reserve subordinated certificates. During the year ended May 31, 2011, no guaranteed bonds requiring a debt service reserve fund were fully repaid and no new guarantees requiring a debt service reserve fund were made. This resulted in no reduction to the debt service reserve fund and member investments in debt service reserve subordinated certificates. At maturity, the trustee uses the debt service reserve fund to repay the bonds, reducing the amount that the member must pay. The member is obligated to replenish the debt service reserve fund so the trustee can return the pledged funds to us since the guaranteed tax-exempt bonds have been repaid. We offset our requirement to repay the member the amount of the debt service reserve subordinated certificate against our right to collect the amount of the debt service reserve fund from the trustee. As a result, the member's obligation to replenish the debt service reserve fund is met. The reduction to the debt service reserve fund and the debt service reserve subordinated certificates on our consolidated balance sheet are offsetting and disclosed as a non-cash transaction in the consolidated statement of cash flows. At inception of the guarantee transaction, the trustee sets aside the required debt service reserve fund amount out of the bond proceeds to be held as the asset pledged by CFC. CFC records a liability for the member's investment in debt service reserve subordinated certificates and records an asset for the debt service reserve fund. Since the trustee holds the cash out of the proceeds, the increase to the debt service reserve fund and increase to the debt service reserve subordinated certificates are disclosed as a non-cash transaction in the consolidated statement of cash flows.

(m) Foreclosed Assets

We initially record foreclosed assets received in satisfaction of loan receivables at fair value or fair value less costs to sell and maintain these assets on the consolidated balance sheets as foreclosed assets. Generally, we intend to sell foreclosed assets. We evaluate whether our foreclosed assets meet the conditions to qualify for assets held for sale and, if so, we record these assets at the lower of the carrying amount or fair value less costs to sell at each reporting date with changes for the period recorded in the consolidated statement of operations. Foreclosed assets that do not qualify as assets held for sale are periodically evaluated for impairment. Any loss due to impairment for the period is recorded in the consolidated statement of operations and establishes a new cost basis. Subsequent increases in fair value on certain foreclosed assets including those that qualify as held for sale are recorded as gains, and are limited to the cumulative amount of loss in fair value recognized in prior periods. If applicable, no depreciation is recorded on such foreclosed assets. The results of operations from foreclosed assets are shown separately on the consolidated statements of operations.

(n) Derivative Financial Instruments

We are an end user of financial derivative instruments. We use derivatives such as interest rate swaps and treasury locks to mitigate interest rate risk. Consistent with the accounting standards for derivative financial instruments, we record derivative instruments on the 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 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 consolidated statements of cash flows.

(o) Debt

Debt securities are reported at cost net of discounts or premiums. Issuance costs on all debt except dealer commercial paper and discounts are deferred and amortized as interest expense using the effective interest method or a method approximating the effective interest method over the legal maturity of each bond issue. Issuance costs on dealer commercial paper are recognized as incurred.

(p) Membership Fees

Members are charged a one-time membership fee based on member class. CFC distribution system members, power supply system members and national associations of cooperatives pay a $1,000 membership fee. CFC service organization members pay a $200 membership fee and CFC associates pay a $1,000 fee. RTFC voting members pay a $1,000 membership fee and RTFC associates pay a $100 fee. NCSC members pay a $100 membership fee. Membership fees are accounted for as members' equity.

(q) Financial Instruments with Off-Balance Sheet Risk

In the normal course of business, we are a party to financial instruments with off-balance sheet risk to meet the financing needs of our member borrowers. These financial instruments include committed lines of credit, standby letters of credit and guarantees of members' obligations.

(r) Interest Income

Interest income on loans is recognized using the effective interest method. The following table presents the components of interest income for the years ended May 31:

(dollar amounts in thousands)	2012	2011	2010
Interest on long-term fixed-rate loans	$ 878,604	$ 904,464	$ 897,648
Interest on long-term variable-rate loans	24,374	45,590	75,330
Interest on line of credit loans	30,717	44,346	56,055
Interest on restructured loans	16,191	2,789	3,188
Interest on non-performing loans	-	149	-
Interest on investments	3,934	3,830	5,245
Fee income (1)	7,141	7,743	6,169
Total interest income	$ 960,961	$ 1,008,911	$ 1,043,635

(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 consolidated balance sheets primarily includes deferred conversion fees totaling $20 million and $12 million at May 31, 2012 and 2011, respectively.

(s) Interest Expense

The following table presents the components of interest expense for the years ended May 31:

(dollar amounts in thousands)	2012	2011	2010
Interest expense on debt (1):			
Commercial paper and bank bid notes	$ 5,836	$ 8,886	$ 7,489
Medium-term notes	173,927	241,545	278,972
Collateral trust bonds	314,642	306,332	320,059
Subordinated deferrable debt	11,225	13,358	19,663
Subordinated certificates	81,124	82,057	79,391
Long-term notes payable	154,606	167,700	184,958
Debt issuance costs (2)	9,044	10,358	10,927
Fee expense (3)	11,374	10,844	10,652
Total interest expense	$ 761,778	$ 841,080	$ 912,111

(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 or a method approximating 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.

(t) Settlement Income

On February 25, 2010, CoBank, ACB, a federally chartered instrumentality of the United States that is a government-sponsored enterprise that lends to agribusinesses and rural utilities throughout the United States, agreed to a settlement relating to our discovery that for a period of years, CoBank, ACB, employees improperly accessed confidential and proprietary information from our password-protected website for members. The settlement included a monetary payment of $23 million to us as well as non-monetary commitments, including an agreement not to engage in the challenged conduct in the future. The settlement income, classified as non-interest income on the statement of operations, is net of legal and other related expenses.

(u) 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 year ended May 31, 2012

(v) Income Taxes

While CFC is exempt under Section 501(c)(4) of the Internal Revenue Code, it is subject to tax on unrelated business taxable income. RTFC is a taxable cooperative under Subchapter T of the Internal Revenue Code and is not subject to income taxes on income from patronage sources that is allocated to its borrowers, as long as the allocation is properly noticed and at least 20 percent of the amount allocated is retired in cash prior to filing the applicable tax return. RTFC pays income tax based on its net income, excluding amounts allocated to its borrowers. NCSC is a taxable cooperative that pays income tax on the full amount of its net income.

The income tax benefit (expense) recorded in the consolidated statement of operations for the years ended May 31, 2012, 2011 and 2010 represents the income tax benefit (expense) for RTFC and NCSC at the combined federal and applicable state income tax rates resulting in approximately 38 percent tax rate. Additionally, fines or penalties assessed against RTFC and NCSC, if any, are recorded in income tax expense.

(w) Comprehensive (Loss) Income

Comprehensive income includes our net income, unrealized gains and losses on derivatives and available-for-sale securities, and the reclassification adjustment for realized gains on derivatives related to the amortization of our derivative transition adjustment and cash settlement gains on hedged forecasted debt transactions. Comprehensive income is calculated as follows for the years ended May 31:

(dollar amounts in thousands)	2012	2011	2010
Net (loss) income	$ (148,797)	$ 151,215	$110,547
Other comprehensive income:			
Add: Unrealized gains (losses) on securities	444	(30)	515
Unrealized gains on derivatives	-	2,551	-
Less: Realized gains on derivatives	(1,028)	(795)	(654)
Comprehensive (loss) income	(149,381)	152,941	110,408
Less: Comprehensive loss (income) attributable to the noncontrolling interest	4,095	(1,761)	(207)
Comprehensive (loss) income attributable to CFC	$ (145,286)	$ 151,180	$110,201

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(x) Use of Estimates

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 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.

(y) Reclassifications

Reclassifications of prior period amounts have been made to conform to the current reporting format and the presentation in our Form 10-K for the year ended May 31, 2012. Specifically, the fair value adjustments on DRP foreclosed assets have been reclassified into results of operations of foreclosed assets in the consolidated statements of operations for the years ended May 31, 2011 and 2010. The corresponding non-cash adjustments were reclassified to the results of operations of foreclosed assets on the consolidated statements of cash flows for the years ended May 31, 2011 and 2010.

(2) Investments in Equity Securities

The activity for our investments in equity securities is summarized below as of and for the years ended May 31:

(dollar amounts in thousands)	2012	2011
Beginning balance	$ 58,601	$ 58,607
Investments purchased	-	24
Fair value adjustment on available-for-sale securities	444	(30)
Ending balance	$ 59,045	$ 58,601

At May 31, 2012 and 2011, our investments in equity securities included investments in the Federal Agricultural Mortgage Corporation Series C preferred stock totaling $58 million.

At May 31, 2012 and 2011, our investments in equity securities also included investments in the Federal Agricultural Mortgage Corporation Series A common stock. Our investment in this Series A common stock is accounted for as available-for-sale securities and recorded in the consolidated balance sheets at fair value. At May 31, 2012 and 2011, the carrying value was $1.4 million and $1 million, respectively, which included the $0.5 million cost of purchases and an unrealized gain of $0.9 million and $0.5 million, respectively, recorded in accumulated other comprehensive income on the consolidated balance sheet.

Starting in March 2011, under a note purchase agreement entered into with the Federal Agricultural Mortgage Corporation, if required by the terms of a pricing agreement for an advance, we may be required to purchase the Federal Agricultural Mortgage Corporation Series C cumulative, redeemable, non-voting preferred stock in an amount equal to 4 percent of the applicable advance, unless the advance is to refinance a prior advance that did not initially require a stock purchase, or if we already own or have agreed to purchase such stock in an amount equal to 4 percent of the aggregate principal amount of all notes outstanding under all note purchase agreements with the Federal Agricultural Mortgage Corporation. As part of our agreement with the Federal Agricultural Mortgage Corporation to guarantee our secured Clean Renewable Energy Bonds Series 2009A, the percentage of debt we are required to

purchase is 2 percent. Cash dividends compound quarterly at the annual rate of 5 percent for the first five years, 7 percent for the second five years and 9 percent following the 10th anniversary of the issue date, so long as the preferred stock remains outstanding. The Federal Agricultural Mortgage Corporation is entitled, in its sole discretion, to redeem some or all of the issued and outstanding shares of the Series C preferred stock subject to receipt of the prior written approval of the Farm Credit Administration, if required, on the first anniversary of the issue date and on each subsequent dividend payment date. See Note 6, Long-Term Debt, for additional information on our note purchase agreements with the Federal Agricultural Mortgage Corporation.

(3) Loans and Commitments

We are a cost-based lender that offers long-term fixed and variable-rate loans and line of credit loans. On long-term 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. Unadvanced commitments are approved and executed loan contracts for which the funds have not yet been advanced. Collateral and security requirements for advances on commitments are identical to those required at the time of the initial loan approval.

Loans outstanding to members and unadvanced commitments by loan type and by member class are summarized as follows at May 31:

	2012		2011	
(dollar amounts in thousands)	Loans outstanding	Unadvanced commitments (1)	Loans outstanding	Unadvanced commitments (1)
Total by loan type (2):				
Long-term fixed-rate loans	$ 16,742,914	$ -	$ 16,404,940	$ -
Long-term variable-rate loans	764,815	5,437,881	1,278,391	5,461,484
Loans guaranteed by RUS (3)	219,084	-	226,695	-
Line of credit loans	1,184,929	8,691,543	1,414,650	8,609,191
Total loans outstanding	18,911,742	14,129,424	19,324,676	14,070,675
Deferred origination costs	7,870	-	6,121	-
Less: Allowance for loan losses	(143,326)	-	(161,177)	-
Net loans outstanding	$ 18,776,286	$ 14,129,424	$ 19,169,620	$ 14,070,675
Total by member class (2):				
CFC:				
Distribution	$ 14,075,471	$ 9,191,227	$ 13,760,228	$ 9,369,765
Power supply	3,596,820	3,714,241	4,092,290	3,579,437
Statewide and associate	73,606	123,189	88,961	125,483
CFC total	17,745,897	13,028,657	17,941,479	13,074,685
RTFC	571,566	341,792	859,122	366,060
NCSC	594,279	758,975	524,075	629,930
Total loans outstanding	$ 18,911,742	$ 14,129,424	$ 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 at May 31:

	2012		2011	
(dollar amounts in thousands)	Loans outstanding	Unadvanced commitments (1)	Loans outstanding	Unadvanced commitments (1)
Non-performing and restructured loans:				
Non-performing loans:				
CFC:				
Long-term variable-rate loans	$ 8,194	$ -	$ 8,194	$ -
Line of credit loans (2)	26,049	-	23,150	2,586
RTFC:				
Long-term fixed-rate loans	6,970	-	-	-
Total non-performing loans	$ 41,213	$ -	$ 31,344	$ 2,586

Restructured loans:				
CFC:				
Long-term fixed-rate loans (3)	$ 455,689	$ -	$ 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	$ 455,689	$ 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 May 31, 2012, loans outstanding included $416 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 $1,303 million and $999 million of unadvanced commitments at May 31, 2012 and 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 will 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 May 31, 2012, and the related maturities by fiscal year as follows:

(dollar amounts in thousands)	Available balance	Notional maturities of committed lines of credit 2013	2014	2015	2016	2017
Committed lines of credit	$1,302,909	$ 127,135	$ 326,634	$ 91,800	$ 248,500	$ 508,840

The remaining unadvanced commitments totaling $12,826 million and $13,072 million at May 31, 2012 and 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 or 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 at May 31:

	2012					
(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
CFC:						
Distribution	$ -	$ 29,243	$ 29,243	$ 14,046,228	$ 14,075,471	$ 29,243
Power supply	-	5,000	5,000	3,591,820	3,596,820	5,000
Statewide and associate	-	-	-	73,606	73,606	-
CFC total	-	34,243	34,243	17,711,654	17,745,897	34,243
RTFC	-	4,306	4,306	567,260	571,566	6,970
NCSC	-	-	-	594,279	594,279	-
Total loans outstanding	$ -	$ 38,549	$ 38,549	$ 18,873,193	$ 18,911,742	$ 41,213
As a % of total loans	-%	0.20%	0.20%	99.80%	100.00%	0.22%

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

	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 not 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 May 31:

	2012			2011		
(dollar amounts in thousands)	Pass	Criticized	Total	Pass	Criticized	Total
CFC:						
Distribution	$ 14,046,228	$ 29,243	$ 14,075,471	$ 13,728,884	$ 31,344	$13,760,228
Power supply	3,591,820	5,000	3,596,820	4,092,290	-	4,092,290
Statewide and associate	73,606	-	73,606	88,961	-	88,961
CFC total	17,711,654	34,243	17,745,897	17,910,135	31,344	17,941,479
RTFC	564,596	6,970	571,566	850,817	8,305	859,122
NCSC	594,279	-	594,279	524,075	-	524,075
Total loans outstanding	$ 18,870,529	$ 41,213	$ 18,911,742	$ 19,285,027	$ 39,649	$ 19,324,676

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, American Samoa and Guam. At May 31, 2012 and 2011, loans outstanding to borrowers in any state or territory did not exceed 17 percent and 19 percent, respectively, of total loans outstanding. CFC, RTFC and NCSC each have policies limiting the amount of credit that can be extended to individual borrowers or a controlled group of borrowers. At May 31, 2012 and 2011, the total exposure outstanding to any one borrower or controlled group did not exceed 2.4 percent of total loans and guarantees outstanding. At May 31, 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 shows the exposure to the 10 largest borrowers as a percentage of total credit exposure broken down by exposure type and by borrower type at May 31:

	2012		2011	
(dollar amounts in thousands)	Amount	%	Amount	%
Total by type:				
Loans	$ 2,852,364	14%	$3,206,808	16%

Guarantees	481,706	3	302,771	1
Total credit exposure to 10 largest borrowers	$ 3,334,070	17%	$3,509,579	17%
Total by borrower type:				
CFC	$ 3,314,070	17%	$3,488,329	17%
NCSC	20,000	-	21,250	-
Total credit exposure to 10 largest borrowers	$ 3,334,070	17%	$3,509,579	17%

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Interest Rates

Below is the weighted-average loan balance and weighted-average yield earned during the fiscal years ended May 31:

	2012		2011	
(dollar amounts in thousands)	Weighted-average loans outstanding	Weighted-average yield	Weighted-average loans outstanding	Weighted-average yield
Total by loan type:				
Long-term fixed-rate loans	$ 16,440,288	5.34%	$16,297,697	5.55%
Long-term variable-rate loans	658,847	3.70	914,979	4.98
Line of credit loans	1,072,222	2.86	1,415,919	3.13
Restructured loans	461,670	3.51	487,570	0.57
Non-performing loans	39,953	-	242,890	0.06
Total loans	$ 18,672,980	5.09	$19,359,055	5.15
Total by borrower type:				
CFC	$ 17,423,330	5.08%	$17,787,856	5.15%
RTFC	688,087	5.44	1,107,287	4.98
NCSC	561,563	5.00	463,912	5.68
Total	$ 18,672,980	5.09	$19,359,055	5.15

In general, a borrower can select a fixed interest rate on long-term loans for periods of one to 35 years or a variable rate. Upon expiration of the selected fixed interest rate term, the borrower must select a variable rate or select another fixed-rate term for a period that does not exceed the remaining loan maturity. We set long-term fixed rates daily and variable rates monthly. Upon notification to borrowers, we may adjust the variable interest rate semi-monthly.

Loan Repricing

Long-term fixed-rate loans outstanding at May 31, 2012, which will be subject to interest rate repricing during the next five fiscal years, are summarized as follows (due to principal repayments, amounts subject to interest rate repricing may be lower at the actual time of interest rate repricing):

(dollar amounts in thousands)	Amount repricing	Weighted-average interest rate
2013	$ 1,800,335	4.78%
2014	1,303,367	4.90
2015	1,031,172	5.10
2016	904,182	5.04
2017	604,866	5.30
Thereafter	2,294,973	5.82

Loan Amortization

On most long-term loans, level quarterly payments are required with respect to principal and interest in amounts sufficient to repay the loan principal, generally over periods of up to 35 years from the date of the secured promissory note.

The following table summarizes the principal amortization of long-term loans by loan type in each of the five fiscal years following May 31, 2012 and thereafter as follows:

Fixed-rate	Variable-rate

(dollar amounts in thousands)	Loan amortization (1)	Weighted-average interest rate	Loan amortization (1)	Total loan amortization (1)
2013	$ 969,079	4.97%	$ 56,752	$ 1,025,831
2014	902,844	5.10	57,671	960,515
2015	883,692	5.23	47,929	931,621
2016	889,391	5.23	79,213	968,604
2017	812,499	5.31	52,516	865,015
Thereafter	12,479,426	5.57	495,801	12,975,227
Total	$ 16,936,931	5.46	$ 789,882	$ 17,726,813

(1) Represents scheduled amortization based on current rates without consideration for loans that reprice.

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 as of May 31:

(dollar amounts in thousands)	2012				2011			
Total by loan type:	Secured	%	Unsecured	%	Secured	%	Unsecured	%
Long-term fixed-rate loans	$ 16,168,857	97%	$ 574,057	3%	$ 15,583,068	95%	$ 821,872	5%
Long-term variable-rate loans	661,115	86	103,700	14	1,207,580	94	70,811	6
Loans guaranteed by RUS	219,084	100	-	-	226,695	100	-	-
Line of credit loans	205,143	17	979,786	83	107,193	8	1,307,457	92
Total loans outstanding	$ 17,254,199	91	$ 1,657,543	9	$ 17,124,536	89	$ 2,200,140	11
Total by company:								
CFC	$ 16,317,195	92%	$ 1,428,702	8%	$ 16,180,454	90%	$ 1,761,025	10%
RTFC	549,085	96	22,481	4	628,020	73	231,102	27
NCSC	387,919	65	206,360	35	316,062	60	208,013	40
Total loans outstanding	$ 17,254,199	91	$ 1,657,543	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 based on borrower type as of and for the years ended May 31:

	2012			
(dollar amounts in thousands)	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	(16,976)	127	(1,259)	(18,108)
Recoveries of loans previously charged-off	211	46	-	257
Balance as of May 31, 2012	$ 126,941	$ 8,562	$ 7,823	$ 143,326

	2011			
(dollar amounts in thousands)	CFC	RTFC (1)	NCSC (1)	Total

	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	(34,160)	(49,016)	166	(83,010)
Charge-offs	-	(354,248)	(28)	(354,276)
Recoveries of loans previously charged-off	211	5,439	49	5,699
Balance as of May 31, 2011	$ 143,706	$ 8,389	$ 9,082	$ 161,177

	2010			
(dollar amounts in thousands)	CFC	RTFC (1)	NCSC (1)	Total
Balance as of May 31, 2009	$ 224,688	$ 378,194	$ 20,078	$ 622,960
(Recovery of) provision for loan losses	(47,245)	28,020	(11,190)	(30,415)
Charge-offs	-	-	(108)	(108)
Recoveries of loans previously charged-off	212	-	115	327
Balance as of May 31, 2010	$ 177,655	$ 406,214	$ 8,895	$ 592,764

(1) The allowance for loan losses recorded for RTFC and NCSC are held at CFC with the exception of $18 thousand of the NCSC loan loss allowance required to cover the exposure for consumer loans at May 31, 2010.

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 as of and for the years ended May 31:

	2012			
(dollar amounts in thousands)	CFC	RTFC	NCSC	Total
Ending balance of the allowance:				
Collectively evaluated	$ 103,681	$ 6,561	$ 7,823	$ 118,065
Individually evaluated	23,260	2,001	-	25,261
Total ending balance of the allowance	$ 126,941	$ 8,562	$ 7,823	$ 143,326
Recorded investment in loans:				
Collectively evaluated	$ 17,255,965	$ 564,596	$ 594,279	$ 18,414,840
Individually evaluated	489,932	6,970	-	496,902
Total recorded investment in loans	$ 17,745,897	$ 571,566	$ 594,279	$ 18,911,742
Loans to members, net (1)	$ 17,618,956	$ 563,004	$ 586,456	$ 18,768,416

	2011			
(dollar amounts in thousands)	CFC	RTFC	NCSC	Total
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 May 31, 2012 and 2011, respectively.

Impaired Loans

Our recorded investment in individually-impaired loans and the related specific valuation allowance is summarized below by member class at May 31:

	2012		2011	
(dollar amounts in thousands)	Recorded investment	Related allowance	Recorded investment	Related allowance
With no specific allowance recorded:				

CFC/Distribution	$ 415,692	$ -	$ 40,413	$ -
With a specific allowance recorded:				
CFC/Distribution	69,240	23,009	465,312	36,576
CFC/Power Supply	5,000	251	-	-
RTFC	6,970	2,001	-	-
Total	81,210	25,261	465,312	36,576
Total impaired loans	$ 496,902	$ 25,261	$ 505,725	$ 36,576

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

The table below represents the average recorded investment in impaired loans and the interest income recognized by member class for the years ended May 31:

	Average recorded investment			Interest income recognized		
(in thousands)	2012	2011	2010	2012	2011	2010
CFC/Distribution	$ 490,609	$ 512,316	$ 514,738	$ 16,191	$ 2,789	$ 2,861
CFC/Power Supply	3,167	-	-	-	-	-
RTFC	6,196	206,945	523,820	-	-	-
Total impaired loans	$ 499,972	$ 719,261	$ 1,038,558	$ 16,191	$ 2,789	$ 2,861

Non-performing and Restructured Loans

Interest income was reduced as follows as a result of holding loans on non-accrual status for the years ended May 31:

(dollar amounts in thousands)	2012	2011	2010
Non-performing loans	$ 1,637	$ 8,886	$ 29,223
Restructured loans	6,714	22,208	23,627
Total	$ 8,351	$ 31,094	$ 52,850

At May 31, 2012 and 2011, non-performing loans included $41 million, or 0.2 percent, of loans outstanding and $31 million, or 0.2 percent, of loans outstanding, respectively. Two borrowers in this group are currently in bankruptcy. In one of the bankruptcy cases, the borrower has until September 14, 2012 to file a plan of reorganization. The other bankruptcy case does not yet have a scheduled date for the borrower to file a plan of reorganization. There are two other borrowers that are currently seeking buyers for their systems, as it is not anticipated that they will have sufficient cash flow to repay their loans without the proceeds from the sale of the business. It is currently anticipated that even with the sale of the business, there will not be sufficient funds to repay the full amount owed.

At May 31, 2012 and 2011, we had restructured loans totaling $456 million, or 2.4 percent, of loans outstanding and $474 million, or 2.5 percent, of loans outstanding, respectively, all of which were performing according to their restructured terms. Approximately $16 million of interest income was accrued on restructured loans during the year ended May 31, 2012 compared with $3 million of interest income in the prior year. One of the restructured loans totaling $40 million at both May 31, 2012 and 2011 has been on accrual status since the time of restructuring. The other restructured loan totaling $416 million and $434 million at May 31, 2012 and 2011, respectively, was on non-accrual status through September 30, 2011, with all amounts collected being applied against the principal balance. On October 1, 2011, the principal balance of the loan was reduced below the level of a buyout option and as such we placed the loan on accrual status at that time at a rate based on the effective rate returned by the future scheduled cash flows.

We believe our allowance for loan loss is adequate to cover the losses inherent in our loan portfolio at May 31, 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 5, Short-Term Debt and Credit Arrangements and Note 6, Long-Term Debt) at May 31:

(dollar amounts in thousands)	2012	2011
Collateral trust bonds:		
2007 indenture		
Distribution system mortgage notes	$ 5,833,475	$ 4,605,921
RUS guaranteed loans qualifying as permitted investments	170,024	-
Total pledged collateral	$ 6,003,499	$ 4,605,921
Collateral trust bonds outstanding	4,850,000	4,050,000
1994 indenture		
Distribution system mortgage notes	$ 1,574,823	$ 1,740,956

Collateral trust bonds outstanding	1,470,000	1,475,000
Federal Agricultural Mortgage Corporation:		
Distribution and power supply system mortgage notes	$ 1,379,989	$ 1,786,777
Notes payable outstanding	1,165,100	1,410,800
Clean Renewable Energy Bonds Series 2009A:		
Distribution and power supply system mortgage notes	$ 25,640	$ 29,857
Cash	7,669	7,664
Total pledged collateral	$ 33,309	$ 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 USDA (see Note 6, Long-Term Debt).

The following table shows the collateral on deposit and the amount of the corresponding debt outstanding at May 31:

(dollar amounts in thousands)	2012	2011
Federal Financing Bank		
Distribution and power supply system mortgage notes on deposit	$ 3,814,311	$ 3,616,040
Notes payable outstanding	3,419,000	3,150,000

The $3,419 million and $3,150 million, respectively, of notes payable to the Federal Financing Bank at May 31, 2012 and 2011 contain a rating trigger related to our senior secured credit ratings from Standard & Poor's Corporation and Moody's Investors Service. A rating trigger event exists if our senior secured debt does not have at least one of the following ratings: (i) A- or higher from Standard & Poor's Corporation, (ii) A3 or higher from Moody's Investors Service or (iii) an equivalent rating from a successor rating agency to any of the above rating agencies. If our senior secured credit ratings fall below the levels listed above, the mortgage notes on deposit at that time, which totaled $3,814 million at May 31, 2012, would be pledged as collateral rather than held on deposit. At May 31, 2012, our senior secured debt ratings from Standard & Poor's Corporation and Moody's Investors Service were A+ and A1, respectively. At May 31, 2012, both Standard & Poor's Corporation and Moody's Investors Service had our ratings on stable outlook.

A total of $2,419 million and $2,150 million of these notes payable to the Federal Financing Bank at May 31, 2012 and 2011, respectively, have a second trigger requiring that a director on the CFC Board of Directors satisfies the requirements of a financial expert as defined by Section 407 of the Sarbanes-Oxley Act of 2002. A financial expert triggering event will occur if the financial expert position remains vacant for more than 90 consecutive days. If CFC does not satisfy the financial expert requirement, the mortgage notes on deposit at that time, which totaled $2,715 million at May 31, 2012, would be pledged as collateral rather than held on deposit. The financial expert position on the CFC Board of Directors has been filled since March 2007.

(4) Foreclosed Assets

Assets received in satisfaction of loan receivables are initially recorded at fair value when received and are subsequently evaluated periodically for impairment. These assets are classified on the consolidated balance sheets as foreclosed assets. At May 31, 2012 and 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 years ended May 31:

	2012			2011		
(dollar amounts in thousands)	CAH	DRP	Total	CAH	DRP	Total
Beginning balance	$ 246,643	$ 34,168	$ 280,811	$ -	$ 42,252	$ 42,252
Results of operations:						
Operating loss	(19,621)	(161)	(19,782)	(11,903)	(125)	(12,028)
Impairment	(45,175)	(2,540)	(47,715)	-	(3,961)	(3,961)
Entity value at transfer	-	-	-	253,896	-	253,896
Cash investments (proceeds)	19,711	(9,549)	10,162	4,650	(3,998)	652
Ending balance	$ 201,558	$ 21,918	$ 223,476	$ 246,643	$ 34,168	$ 280,811

On October 6, 2010, CFC, through its wholly owned subsidiary CAH, obtained control of 100 percent of the equity interests of ICC's USVI operating entities and on March 1, 2011, CAH obtained control of 100 percent of the equity interests of ICC's British Virgin Island and St. Maarten operating entities. The transaction, completed in two phases, resulted from the transfer of ICC's assets in bankruptcy. CFC recorded an initial investment of $254 million to foreclosed assets, which includes the $166 million fair value of the entities transferred and an additional investment of $88 million to these entities to pay down or fully settle third-party debt obligations outstanding prior to the transfer.

The transfer of ICC's operating entities to CAH was accounted for using the purchase method of accounting and resulted in the establishment of goodwill on the balance sheet of CAH.

The USVI, British Virgin Island and St. Maarten entities transferred to CFC include the following:

- a regulated incumbent local exchange carrier offering local telephone and broadband services to both business and residential customers in the USVI;
- an Internet service provider serving digital subscriber line (DSL) and dial-up customers in the USVI;
- a long-distance service provider offering interstate and international voice and data services for both business and residential markets in the USVI;
- a wireless telephone service provider in the USVI; and
- providers of cable television services in St. Thomas, St. John and St. Croix, USVI, the British Virgin Islands and St. Maarten.

During the third quarter of fiscal year 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 and 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 to date 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 intangible assets, in which the sum of undiscounted cash flows associated with these assets were compared with their carrying values. Furthermore, a valuation analysis was performed on the CAH operating entities to determine the fair value of such entities and such fair values were compared with 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 year ended May 31, 2012. In addition to these impairment charges, our reported results of operations of foreclosed assets included a net loss of $20 million for the year ended May 31, 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.

All CAH results of operations, which include goodwill and other asset impairment charges, will not affect our compliance with debt covenants under our existing indentures and credit facility agreements.

During the year, our investment in the DRP foreclosed assets decreased as a result of experiencing approximately $2 million of deterioration in the fair value of land developments, raw land and underground mineral rights. In addition, net cash proceeds from the sale of foreclosed assets as well as proceeds from the reimbursement of infrastructure bonds issued by the county in which these foreclosed assets reside, also contributed to the decrease in our investment in DRP foreclosed assets by approximately $10 million.

(5) Short-Term Debt and Credit Arrangements

The following is a summary of short-term debt outstanding and the effective interest rates at May 31:

	2012		2011	
(dollar amounts in thousands)	Debt Outstanding	Effective Interest Rate	Debt Outstanding	Effective Interest Rate
Short-term debt:				
Commercial paper sold through dealers, net of discounts	$ 1,404,901	0.19%	$ 1,471,715	0.26%
Commercial paper sold directly to members, at par	997,778	0.19	1,189,770	0.23
Commercial paper sold directly to non-members, at par	70,479	0.19	55,160	0.21
Total commercial paper	2,473,158	0.19	2,716,645	0.25
	478,406	0.10	308,725	0.15

Daily liquidity fund notes sold directly to members				
Bank bid notes	295,000	0.52	295,000	0.60
Subtotal short-term debt	3,246,564	0.20	3,320,370	0.27
Long-term debt maturing within one year:				
Medium-term notes sold through dealers	232,830	1.47	1,986,891	6.12
Medium-term notes sold to members	409,961	1.63	266,067	1.91
Secured collateral trust bonds	254,962	2.90	5,000	7.45
Member subordinated certificates	16,710	3.03	12,440	3.29
Secured notes payable	327,006	2.52	247,507	1.41
Unsecured notes payable	5,401	5.86	4,649	5.22
Total long-term debt maturing within one year	1,246,870	2.13	2,522,554	5.20
Total short-term debt	$ 4,493,434	0.74	$ 5,842,924	2.40

We issue commercial paper for periods of one to 270 days. We also enter into short-term bank bid note agreements, which are unsecured obligations that do not require backup bank lines of credit for liquidity purposes. We do not pay a commitment fee for bank bid notes. The commitments are generally subject to termination at the discretion of the individual banks.

Revolving Credit Agreements

At May 31, 2012 and 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 May 31, 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 at May 31:

	Total available		Letters of credit outstanding			
(dollar amounts in thousands)	2012	2011	2012	2011	Original maturity	Facility fee per year (1)
Three-year agreement	$ 1,125,000	$1,125,000	$ -	$ -	March 21, 2014	15 basis points
Four-year agreement	883,875	-	1,000	-	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	$ 2,843,750	$3,544,526	$ 1,000	$ 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.

For calculating the required financial covenants in our revolving credit agreements, we adjust net income, senior debt and total equity to exclude the non-cash adjustments from the accounting for derivative financial instruments and foreign currency translation. Additionally, the times interest earned ratio ("TIER") and senior debt to total equity ratio include the following adjustments:

- The adjusted TIER, as defined by the agreements, represents the interest expense adjusted to include the derivative cash settlements plus net income prior to the cumulative effect of change in accounting principle and dividing that total by the interest expense adjusted to include the derivative cash settlements.
- The senior debt to total equity ratio includes adjustments to senior debt to exclude RUS-guaranteed loans, subordinated deferrable debt and members' subordinated certificates. Total equity is adjusted to include subordinated deferrable debt and members' subordinated certificates. Senior debt includes guarantees; however, it excludes:

– guarantees for members where the long-term unsecured debt of the member is rated at least BBB+ by Standard & Poor's Corporation or Baa1 by Moody's Investors Service; and

- the payment of principal and interest by the member on the guaranteed indebtedness if covered by insurance or reinsurance provided by an insurer having an insurance financial strength rating of AAA by Standard & Poor's Corporation or a financial strength rating of Aaa by Moody's Investors Service.

- The CAH results of operations are eliminated from the CFC financial results used to calculate both the adjusted TIER ratio and the senior debt-to-equity ratio.

The following represents our required and actual financial ratios under the revolving credit agreements at or for the years ended May 31:

		Actual	
	Requirement	2012	2011
Minimum average adjusted TIER over the six most recent fiscal quarters (1)	1.025	1.21	1.19
Minimum adjusted TIER for the most recent fiscal year (1) (2)	1.05	1.18	1.21
Maximum ratio of adjusted senior debt to total equity (1)	10.00	5.97	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 and debt-to-equity calculations include the adjustments set forth in the Non-GAAP Financial Measures section and exclude the results of operations for CAH.
(2) We must meet this requirement to retire patronage capital.

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

(6) Long-Term Debt

The following is a summary of long-term debt outstanding and the weighted average effective interest rates at May 31:

	2012		2011	
(dollar amounts in thousands)	Debt Outstanding	Weighted-Average Effective Interest Rate	Debt Outstanding	Weighted-Average Effective Interest Rate
Unsecured long-term debt:				
Medium-term notes sold through dealers (1)	$ 1,692,605	5.98%	$ 1,298,412	7.21 %
Medium-term notes sold to members (2)	89,261	1.63	105,894	1.91
Subtotal	1,781,866	5.76	1,404,306	6.81
Unamortized discount	(971)		(990)	
Total unsecured medium-term notes	1,780,895		1,403,316	
Unsecured notes payable (3)	3,457,982	3.04	3,194,390	3.30
Unamortized discount	(1,093)		(1,279)	
Total unsecured notes payable	3,456,889		3,193,111	
Total unsecured long-term debt	5,237,784	3.97	4,596,427	4.37
Secured long-term debt:				
Collateral trust bonds				
2.625% Bonds, due 2012	-	-	250,000	2.81
1.125% Bonds, due 2013	300,000	1.27	300,000	1.27
5.50% Bonds, due 2013	900,000	5.68	900,000	5.68
4.75% Bonds, due 2014	600,000	4.84	600,000	4.84
1.00% Bonds, due 2015	400,000	1.23	-	-
1.90% Bonds, due 2015	350,000	2.05	350,000	2.05
3.875% Bonds, due 2015	250,000	4.07	250,000	4.07
7.20% Bonds, due 2015	50,000	7.32	50,000	7.32
3.05% Bonds, due 2016	300,000	3.23	300,000	3.23
5.45% Bonds, due 2017	570,000	5.58	570,000	5.58
5.45% Bonds, due 2018	700,000	5.57	700,000	5.57
6.55% Bonds, due 2018	175,000	6.68	175,000	6.68
10.375% Bonds, due 2018	1,000,000	10.61	1,000,000	10.61
3.05% Bonds, due 2022	400,000	3.17	-	-
7.35% Bonds, due 2026 (4)	70,000	7.45	75,000	7.45
Subtotal	6,065,000	5.38	5,520,000	5.72
Unamortized discount	(12,398)		(11,765)	
Total secured collateral trust bonds	6,052,602		5,508,235	
Secured notes payable (5)	861,581	3.02	1,188,587	2.79
Total secured long-term debt	6,914,183	5.08	6,696,822	5.20
Total long-term debt	$ 12,151,967	4.61	$ 11,293,249	4.87

(1) As of May 31, 2012 and 2011, medium-term notes sold through dealers mature through 2032. Excludes $233 million and $1,987 million of medium-term notes sold through dealers that were reclassified as short-term debt at May 31, 2012 and 2011.
(2) Medium-term notes sold to members mature through 2028 as of May 31, 2012 and 2011. Excludes $410 million and $266 million of medium-term notes sold to members that were reclassified as short-term debt at May 31, 2012 and 2011, respectively.
(3) Unsecured notes payable mature through 2033 as of May 31, 2012 and 2011. Excludes $5 million of unsecured notes payable that were reclassified as short-term debt at May 31, 2012 and 2011.
(4) We are required to make mandatory sinking fund payments for these bonds on November 1 of each year through 2025 totaling $5 million to retire 95 percent of the principal amount before maturity.
(5) Secured notes payable mature through 2024 as of May 31, 2012 and 2011. Excludes $327 million and $248 million of secured notes payable that were reclassified as short-term debt at May 31, 2012 and 2011, respectively.

The amount of long-term debt maturing in each of the five fiscal years following May 31, 2012 and thereafter is presented in the table below.

(dollar amounts in thousands)	Amount Maturing	Weighted-Average Interest Rate
2013 (1)	$ -	-%
2014	2,635,635	3.91
2015	844,474	2.00
2016	986,586	3.11
2017	595,358	5.41
Thereafter	7,089,914	5.34
Total	$12,151,967	4.62

(1) The amount scheduled to mature in fiscal year 2013 has been presented as short-term debt in Note 5, Short-Term Debt and Credit Arrangements under long-term debt due in one year.

Medium-Term Notes
Medium-term notes represent unsecured obligations that may be issued through dealers in the capital markets or directly to our members.

Collateral Trust Bonds
Collateral trust bonds represent secured obligations sold to investors in the capital markets. Collateral trust bonds are secured by the pledge of mortgage notes or eligible securities in an amount at least equal to the principal balance of the bonds outstanding. During the year ended May 31, 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. See Note 3, Loans and Commitments, for additional information on the collateral pledged to secure our collateral trust bonds.

Unsecured Notes Payable
At May 31, 2012 and 2011, we had unsecured notes payable totaling $3,419 million and $3,150 million, respectively, 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 USDA, which provides guarantees to the Federal Financing Bank. We pay RUS a fee of 30 basis points per year on the total amount borrowed. At May 31, 2012, $3,419 million of unsecured notes payable outstanding under the Guaranteed Underwriter program require us to place mortgage notes on deposit in an amount at least equal to the principal balance of the notes outstanding. See Note 3, Loans and Commitments, for additional information on the mortgage notes held on deposit and the triggering events that result in these mortgage notes becoming pledged as collateral.

In November 2010, we closed on a $500 million committed loan facility from the Federal Financing Bank with a guarantee of repayment by RUS as part of the funding mechanism for the Guarantee Underwriter Program. Under this facility, CFC is able to borrow up to the committed amount any time before October 15, 2013. 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. In the aggregate at May 31, 2012, we had up to $580 million available under committed loan facilities from the Federal Financing Bank as part of this program.

Secured Notes Payable
At May 31, 2012 and 2011, secured notes payable include $1,165 million and $1,411 million, respectively, in debt outstanding to the Federal Agricultural Mortgage Corporation under note purchase agreements totaling $3,900 million. All note purchase agreements previously entered into with the Federal Agricultural Mortgage Corporation were consolidated into one agreement in March 2011. Under the terms of the 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. 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. Also, if required by the terms of a pricing agreement for an advance, we may be required to purchase the Federal Agricultural Mortgage Corporation Series C cumulative, redeemable, non-voting preferred stock in an amount equal to 4 percent of the applicable advance, unless the advance

is to refinance a prior advance that did not initially require a stock purchase, or if we already own or have agreed to purchase such stock in an amount equal to 4 percent of the aggregate principal amount of all notes outstanding under all note purchase agreements with the Federal Agricultural Mortgage Corporation. See Note 2, Investments in Equity Securities, for additional information about the preferred stock that we purchased. We are required to pledge eligible distribution system or power supply system loans as collateral in an amount at least equal to the total principal amount of notes outstanding under the agreement. See Note 3, Loans and Commitments, for additional information on the collateral pledged to secure notes payable under these programs.

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(7) Subordinated Deferrable Debt

Subordinated deferrable debt represents quarterly income capital securities and subordinated notes that are long-term obligations subordinated to our outstanding debt and senior to subordinated certificates held by our members. Our subordinated deferrable debt was issued for terms of up to 49 years. This debt pays interest quarterly, may be called at par after five years and allows us to defer the payment of interest for up to 20 consecutive quarters. To date, we have not exercised our right to defer interest payments.

The following table is a summary of subordinated deferrable debt outstanding and the effective interest rates at May 31:

	2012		2011	
(dollar amounts in thousands)	Amounts Outstanding	Effective Interest Rate	Amounts Outstanding	Effective Interest Rate
NRC 6.10% due 2044	$ 88,201	6.33%	$ 88,201	6.33%
NRU 5.95% due 2045	98,239	6.14	98,239	6.14
Total	$ 186,440	6.23	$ 186,440	6.23

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

(8) Derivative Financial Instruments

We are an end user of financial derivative instruments. We use derivatives such as interest rate swaps and treasury locks to mitigate interest rate risk.

Generally, our derivative instruments do not qualify for hedge accounting under the accounting standards for derivative financial instruments. The majority of our interest rate exchange agreements use a LIBOR index as either the pay or receive leg. The correlation between movement in LIBOR and movement in our commercial paper rates is not consistently high enough to qualify for hedge accounting. At May 31, 2012 and 2011, we did not have any derivative instruments that were accounted for using hedge accounting. The following table shows the notional amounts outstanding for our interest rate swaps by type at May 31:

(dollar amounts in thousands)	2012	2011
Pay fixed-receive variable	$ 5,275,553	$ 5,638,123
Pay variable-receive fixed	3,720,440	5,301,440
Total interest rate swaps	$ 8,995,993	$ 10,939,563

The derivative losses line item of the 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. Gains and losses recorded on the consolidated statements of operations for our interest rate swaps are summarized below for the years ended May 31:

(dollar amounts in thousands)	2012	2011	2010

Derivative cash settlements (1)	$	(12,846)	$	(6,848) $ (23,304)
Derivative forward value		(223,774)		(23,388) 2,696
Derivative losses	$	(236,620)	$	(30,236) $ (20,608)

(1) The year ended May 31, 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.

Cash settlements for the year ended May 31, 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. In December 2010, we entered into two derivative contracts to mitigate risk on forecasted transactions that settled in January 2011. These transactions received cash flow hedge accounting treatment and, therefore, the cash settlement gain of $3 million was recorded as a component of other comprehensive income based on the fair value of the derivative instruments. This amount will be amortized as a reduction to interest expense using the effective interest method through 2018, the term of the hedged debt. Additionally, we recognized a gain of $0.4 million in derivative cash settlements based on the measurement of ineffectiveness in the hedging relationship.

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 May 31, 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 May 31, 2012, our senior unsecured credit ratings from Moody's Investors Service and Standard & Poor's Corporation were A2 and A, respectively. At May 31, 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	$ (232)	$ -	$ (232)
fall below Baa1/BBB+ (1)	6,817,207	(290,053)	42,348	(247,705)
Total	$ 6,820,207	$ (290,285)	$ 42,348	$ (247,937)

(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 May 31, 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 May 31, 2012 was $297 million.

(9) Members' Subordinated Certificates

Membership Subordinated Certificates
Our members may be required to purchase membership subordinated certificates as a condition of membership. Such certificates are interest-bearing, unsecured, subordinated debt. Members may purchase the certificates over time as a percentage of the amount they borrow from CFC. RTFC and NCSC members are not required to purchase membership certificates as a condition of membership. Membership certificates typically have an original maturity of 100 years and pay interest at 5 percent semi-annually. The weighted-average maturity for all membership subordinated certificates outstanding at May 31, 2012 and 2011 was 64 years and 65 years, respectively.

Loan and Guarantee Subordinated Certificates
Members obtaining long-term loans, certain line of credit loans or guarantees may be required to purchase additional loan or guarantee subordinated certificates with each such loan or guarantee based on the borrower's debt-to-equity ratio with CFC. These certificates are unsecured, subordinated debt and may be interest bearing or non-interest bearing.

Under our current policy, most borrowers requesting standard loans are not required to buy equity certificates as a condition of a loan or guarantee. Borrowers meeting certain criteria, including but not limited to, high leverage ratios, or borrowers requesting large facilities, may be required to purchase loan or guarantee subordinated certificates or

member capital securities (described below) as a condition of the loan. Loan subordinated certificates have the same maturity as the related long-term loan. Some certificates may amortize annually based on the outstanding loan balance.

The interest rates payable on guarantee subordinated certificates purchased in conjunction with our guarantee program vary in accordance with applicable CFC policy. Guarantee subordinated certificates have the same maturity as the related guarantee.

Member Capital Securities

CFC offers member capital securities to its voting members. Member capital securities are interest-bearing unsecured obligations of CFC and are subordinate to all of our existing and future senior indebtedness and all existing and future subordinated indebtedness of CFC that may be held by or transferred to non-members of CFC, but rank proportionally to our member subordinated certificates. Each member capital security matures 35 years from its date of issuance and is callable at par at our option five years from the date of issuance and anytime thereafter. These securities represent voluntary investments in CFC by the members.

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Information with respect to members' subordinated certificates at May 31 is as follows:

(dollar amounts in thousands)	2012 Amounts Outstanding	2012 Weighted-Average Interest Rate	2011 Amounts Outstanding	2011 Weighted-Average Interest Rate
Number of subscribing members	909		905	
Membership subordinated certificates:				
Certificates maturing 2020 through 2095	$ 630,061		$ 629,543	
Subscribed and unissued (1)	16,218		16,618	
Total membership subordinated certificates	646,279	4.90 %	646,161	4.90%
Loan and guarantee subordinated certificates (2):				
3% certificates maturing through 2040	110,996		110,996	
3% to 12% certificates maturing through 2047	274,363		307,160	
Non-interest bearing certificates maturing through 2045	285,479		328,211	
Subscribed and unissued (1)	7,277		10,434	
Total loan and guarantee subordinated certificates	678,115	2.74	756,801	2.56
Member capital securities:				
Securities maturing through 2047	398,350	7.50	398,250	7.50
Total members' subordinated certificates	$1,722,744	4.65	$1,801,212	4.49

(1) The subscribed and unissued subordinated certificates represent subordinated certificates that members are required to purchase, but are not yet paid for. Upon collection of the full amount of the subordinated certificate based on various payment options, the amount of the certificate will be reclassified from subscribed and unissued to outstanding.
(2) Excludes $17 million and $12 million of loan and guarantee subordinated certificates that were reclassified as short-term debt at May 31, 2012 and 2011, respectively.

The amount of members' subordinated certificates maturing in each of the five fiscal years following May 31, 2012 and thereafter is presented in the table below.

(dollar amounts in thousands)	Amount Maturing	Weighted-Average Interest Rate
2013 (1)	$ -	-%
2014	12,431	2.75
2015	28,360	2.80
2016	21,484	2.42
2017	11,510	4.94
Thereafter	1,498,419	5.36
Total (2)	$1,572,204	5.25

(1) The amount scheduled to mature in fiscal year 2013 has been presented as long-term debt due in one year under short-term debt. See Note 5, Short-Term Debt and Credit Arrangements.
(2) Excludes loan subordinated certificates totaling $151 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 2012, amortization represented 14 percent of amortizing loan subordinated certificates outstanding.

(10) Equity

District of Columbia cooperative law requires cooperatives to allocate net earnings to patrons, to a general reserve in an amount sufficient to maintain a balance of at least 50 percent of paid-in capital, and to a cooperative educational fund, as well as permits additional allocations to board-approved reserves. District of Columbia cooperative law also requires that a cooperative’s net earnings be allocated to all patrons in proportion to their individual patronage and each patron’s allocation be distributed to the patron unless the patron agrees that the cooperative may retain its share as additional capital.

Annually, the CFC Board of Directors allocates its net earnings to its patrons in the form of patronage capital, to a cooperative educational fund, to a general reserve, if necessary, and to board-approved reserves. An allocation to the general reserve is made, if necessary, to maintain the balance of the general reserve at 50 percent of the membership fees collected. CFC’s bylaws require the allocation to the cooperative educational fund to be at least 0.25 percent of its net earnings. Funds from the cooperative educational fund are disbursed annually to statewide cooperative organizations to fund the teaching of cooperative principles and for other cooperative education programs.

Currently, CFC has one additional board-approved reserve, the members’ capital reserve. The CFC Board of Directors determines the amount of net earnings that is allocated to the members’ capital reserve, if any. The members’ capital reserve represents net earnings that CFC holds to increase equity retention. The net earnings held in the members’ capital reserve

have not been specifically allocated to members, but may be allocated to individual members in the future as patronage capital if authorized by the CFC Board of Directors.

All remaining net earnings are allocated to CFC's members in the form of patronage capital. The amount of net earnings allocated to each member is based on the members' patronage of CFC's lending programs during the year. No interest is earned by members on allocated patronage capital. There is no effect on CFC's total equity as a result of allocating net earnings to members in the form of patronage capital or to board-approved reserves. The CFC Board of Directors has voted annually to retire a portion of the patronage capital allocation. Upon retirement, patronage capital is paid out in cash to the members to whom it was allocated. CFC's total equity is reduced by the amount of patronage capital retired to its members and by amounts disbursed from board-approved reserves.

The current policy of the CFC Board of Directors is to retire 50 percent of the prior year's allocated patronage capital and hold the remaining 50 percent for 25 years. The retirement amount and timing remains subject to annual approval by the CFC Board of Directors.

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 and $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.

In July 2012, the CFC Board of Directors authorized the allocation of the fiscal year 2012 net earnings as follows: $1 million to the cooperative educational fund and $71 million to members in the form of patronage. In July 2012, the CFC Board of Directors authorized the retirement of allocated net earnings totaling $35 million, representing 50 percent of the fiscal year 2012 allocation. It is anticipated that this amount will be returned to members in cash in September 2012. 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.

Total equity includes noncontrolling interest, which represents 100 percent of RTFC and NCSC equity, as the members of RTFC and NCSC own or control 100 percent of the interest in their respective companies. In accordance with District of Columbia cooperative law and its bylaws and board policies, RTFC allocates its net earnings to its patrons, a cooperative educational fund and a general reserve, if necessary. RTFC's bylaws require that it allocate at least 1 percent of net income to a cooperative educational fund. Funds from the cooperative educational fund are disbursed annually to fund the teaching of cooperative principles and for other cooperative education programs. An allocation to the general reserve is made, if necessary, to maintain the balance of the general reserve at 50 percent of the membership fees collected. The remainder is allocated to borrowers in proportion to their patronage. RTFC retires at least 20 percent of the allocation for that year to members in cash prior to filing the applicable tax return. Any additional amounts are retired as determined by the board of directors with due regard for RTFC's financial condition. In January 2012, RTFC retired $1 million to its members representing 20 percent of allocated net earnings for fiscal year 2011. NCSC's bylaws require that it allocate at least 0.25 percent of its net earnings to a cooperative educational fund and an amount to the general reserve required to maintain the general reserve balance at 50 percent of membership fees collected. Funds from the cooperative educational fund are disbursed annually to fund the teaching of cooperative principles and for other cooperative education programs. The NCSC Board of Directors has the authority to determine if and when net earnings will be retired. There is no effect on noncontrolling interest as a result of RTFC and NCSC allocating net earnings to borrowers or board approved reserves. There is a reduction to noncontrolling interest as a result of the cash retirement of amounts allocated to borrowers or to disbursements from board-approved reserves.

Equity includes the following components at May 31:

(dollar amounts in thousands)	2012	2011
Membership fees	$ 995	$ 994
Education fund	1,418	1,437
Members' capital reserve	272,126	272,126
Allocated net income	546,366	521,897
Unallocated net loss (1)	(6,222)	(6,213)
Total members' equity	814,683	790,241
Prior years cumulative derivative forward value and foreign currency adjustments	(124,476)	(100,778)
Year-to-date derivative forward value loss (2)	(216,243)	(23,698)
Total CFC retained equity	473,964	665,765
Accumulated other comprehensive income	9,199	9,758
Total CFC equity	483,163	675,523
Noncontrolling interest	7,592	11,786
Total equity	$ 490,755	$ 687,309

(1) Excludes derivative forward value.
(2) Represents the derivative forward value loss recorded by CFC for the year-to-date period.

The activity in the accumulated other comprehensive income account is summarized below by component as of and for the years ended May 31:

	2012			2011		
(dollar amounts in thousands)	Unrealized gains on securities	Unrealized gains on derivatives	Total	Unrealized gains (losses) on securities	Unrealized gains on derivatives	Total
Beginning balance	$ 485	$ 9,273	$ 9,758	$ 515	$ 7,489	$ 8,004
Change in fair value	444	-	444	(30)	-	(30)
Unrealized gains	-	-	-	-	2,551	2,551
Realized gains reclassified into earnings	-	(1,003)	(1,003)	-	(767)	(767)
Other comprehensive income	444	(1,003)	(559)	(30)	1,784	1,754
Ending balance	$ 929	$ 8,270	$ 9,199	$ 485	$ 9,273	$ 9,758

Approximately $1 million of the accumulated other comprehensive income is expected to be reclassified into earnings over the next 12 months.

(11) Employee Benefits

CFC is a participant in the NRECA Retirement Security Plan ("the Plan"), a noncontributory, defined benefit multiemployer master pension plan. The employer identification number of the plan is 53-0116145 and the plan number is 333. Plan information is available publicly through the annual Form 5500, including attachments. The plan

is available to all qualified CFC employees. Under the Plan, participating employees are entitled to receive annually, under a 50 percent joint and surviving spouse annuity, 1.70 percent of the average of their five highest base salaries during their last 10 years of employment, multiplied by the number of years of participation in the plan. As a multiemployer plan, there is no funding liability for CFC related to the plan. CFC's expense is limited to the annual premium to participate in the plan.

The risks of participating in CFC's multiemployer plan are different from single-employer plans based on the following characteristics of the Plan:

- Assets contributed to the multiemployer plan by one participating employer may be used to provide benefits to employees of other participating employers.
- If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
- If CFC chooses to stop participating in the Plan, CFC may be required to pay a withdrawal liability representing an amount based on the underfunded status of the plan.

During fiscal year 2011, the Plan was changed to a normal retirement age of 65 (up from age 62) and the annuity factor changed to 1.70 percent from 1.90 percent effective September 1, 2010. Additionally, a pre-retirement death benefit of 100 percent was added effective September 1, 2010 and applies to all earned benefits under the plan.

In the Plan, a certified zone status determination is not required, and therefore not determined, under the Pension Protection Act of 2006. In total, the Plan was between 65 percent and 80 percent funded at January 1, 2012 and 2011 based on the

Pension Protection Act (PPA) funding target and PPA actuarial value of assets on those dates. CFC made contributions of $5 million, $6 million, and $6 million during fiscal years 2012, 2011, and 2010, respectively. In each of these years, these contributions represented less than 5 percent of total contributions made to the plan by all participating employers. There are no collective bargaining agreements in place that cover CFC's employees. At May 31, 2012, CFC's contribution rate did not include a surcharge, there were no funding improvement plans or rehabilitation plans implemented or pending and there were no required minimum contributions.

The Economic Growth and Tax Relief Act of 2001 set a limit of $250,000 for calendar year 2012 on the compensation to be used in the calculation of pension benefits. To restore potential lost benefits, we adopted a Pension Restoration Plan, which is a component of the Retirement Security Plan administered by NRECA. Under the plan, the amount that NRECA invoices CFC for the Retirement Security Plan will continue to be based on the full compensation paid to each employee. Upon the retirement of a covered employee, NRECA will calculate the retirement and security benefit to be paid with consideration of the compensation limits and will pay the maximum benefit thereunder. NRECA will also calculate the retirement and security benefit that would have been available without consideration of the compensation limits and CFC will pay the difference. NRECA will then give CFC a credit against future retirement and security contribution liabilities in the amount paid by CFC to the covered employee.

The Pension Restoration Plan includes a deferred compensation component (Deferred Compensation Pension Restoration Plan). The benefit and payout formula under the restoration component of the Retirement Security Plan is similar to that under the qualified plan component. However, each of the named executive officers has satisfied the provisions established to receive the benefit from this plan. Since there is no longer a risk of forfeiture of the benefit under the Pension Restoration Plan, distributions will be made from the plan to each named executive officer annually and credited back to CFC by NRECA on following pension invoices. Other employees eligible to participate in the Pension Restoration Plan who are not named executive officers, have not yet satisfied the requirements for risk of forfeiture. The Deferred Compensation Pension Restoration Plan benefit shall be payable to the participant in a lump sum payment immediately upon the lapse of the substantial risk of forfeiture.

CFC offers a 401(k) defined contribution savings program, the 401(k) Pension Plan, to all employees that have completed a minimum of 1,000 hours of service in either the first 12 consecutive months or first full calendar year of employment. CFC contributes an amount up to 2 percent of an employee's salary each year for all employees participating in the program with a minimum 2 percent employee contribution. CFC contributed $0.5 million, $0.5 million, and $0.6 million to the plan during fiscal years 2012, 2011, and 2010, respectively.

(12) Guarantees

We guarantee certain contractual obligations of our members so they may obtain various forms of financing. We use the same credit policies and monitoring procedures in providing guarantees as we do for loans and commitments. If a member system defaults on its obligation to pay debt service, then we are obligated to pay any required amounts under our guarantees. Meeting our guarantee obligations satisfies the underlying obligation of our member systems and prevents the exercise of remedies by the guarantee beneficiary based upon a payment default by a member system. In general, the member system is required to repay, on demand, any amount advanced by us with interest, pursuant to the documents evidencing the member system's reimbursement obligation.

The following table summarizes total guarantees by type of guarantee and member class at May 31:

(dollar amounts in thousands)	2012	2011
Total by type:		
Long-term tax-exempt bonds	$ 573,110	$ 599,935
Indemnifications of tax benefit transfers	49,771	59,895

Letters of credit		504,920		327,201
Other guarantees		121,529		117,957
Total	$	1,249,330	$	1,104,988
Total by member class:				
CFC:				
Distribution	$	340,385	$	217,099
Power supply		854,444		817,618
Statewide and associate		7,202		20,807
CFC total		1,202,031		1,055,524
RTFC		1,026		821
NCSC		46,273		48,643
Total	$	1,249,330	$	1,104,988

We guarantee debt issued in connection with the construction or acquisition of pollution control, solid waste disposal, industrial development and electric distribution facilities, classified as long-term tax-exempt bonds in the table above. We unconditionally guarantee to the holders or to trustees for the benefit of holders of these bonds the full principal, interest and in most cases, premium, if any, on each bond when due. If a member system defaults in its obligation to pay debt service, then we are obligated to pay any required amounts under our guarantees. Such payment will prevent the occurrence of an event of default that would otherwise permit acceleration of the bond issue. In general, the member system is required to repay, on demand, any amount advanced by us with interest, pursuant to the documents evidencing the member system's reimbursement obligation.

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 May 31, 2012, our maximum potential exposure for the $75 million of fixed-rate tax-exempt bonds is $126 million, representing principal and interest. Of the amounts shown in the table above for long-term tax-exempt bonds, $498 million and $524 million as of May 31, 2012 and 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 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. The amounts shown in the table above represent our maximum potential exposure, of which $241 million is secured at May 31, 2012. When taking into consideration reimbursement obligation agreements that we have in place with other lenders, our maximum potential exposure related to $23 million of letters of credit would be reduced to $7 million in the event of default. At May 31, 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 May 31, 2012, we may be required to issue up to an additional $787 million in letters of credit to third parties for the benefit of our members. Of this amount, $615 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 3, Loans and Commitments. Master letters of credit facilities subject to material adverse change clauses at the time of issuance totaled $477 million at May 31, 2012. Prior to issuing a letter of credit, we would confirm that there has been no material adverse change in the business or 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 $310 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 $123 million, all of which is unsecured.

At May 31, 2012 and 2011, we had $385 million and $280 million of guarantees representing 31 percent and 25 percent, respectively, of total guarantees, under which our right of recovery from our members was not secured.

Guarantee Liability

At May 31, 2012 and 2011, we recorded a guarantee liability of $29 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 May 31, 2012 and 2011 was $6 million, based on management's estimate of exposure to losses within the guarantee portfolio. The remaining balance of the total guarantee liability of $23 million and

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$16 million at May 31, 2012 and 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 years ended May 31:

(dollar amounts in thousands)	2012	2011	2010
Beginning balance	$ 22,217	$ 22,984	$ 29,672
Net change in non-contingent liability	5,720	(94)	(1,407)
Provision for (recovery of) contingent guarantee liability	726	(673)	(5,281)
Ending balance	$ 28,663	$ 22,217	$ 22,984
Liability as a percentage of total guarantees	2.29%	2.01%	1.96%

The following table details the scheduled maturities of our outstanding guarantees in each of the fiscal years following May 31, 2012:

(dollar amounts in thousands)	Amount maturing
2013	$ 278,181
2014	56,440
2015	314,898
2016	23,069
2017	92,609
Thereafter	484,133
Total	$ 1,249,330

(13) Fair Value Measurement

Fair Value

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Fair value standards, among other things, require that we maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

Fair value standards establish the following fair value hierarchy:

- Level 1 – Quoted prices for identical instruments in active markets.
- Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.
- Level 3 – Instruments whose significant value drivers are unobservable.

When a valuation includes inputs from multiple sources at various levels in the fair value hierarchy, we classify the valuation category at the lowest level for which the input has a significant effect on the overall valuation.

Assets and liabilities measured at fair value on either a recurring or non-recurring basis on the consolidated balance sheets at May 31, 2012 and 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 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 consolidated statements of operations, as currently none of our derivatives qualify for hedge accounting.

At May 31, 2012 and 2011, our investments in equity securities included investments in the Federal Agricultural Mortgage Corporation Series A common stock that is recorded in the 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. For the year ended May 31, 2012, we recorded an unrealized gain of $0.4 million in accumulated other comprehensive income on the consolidated balance sheet. For the year ended May 31, 2011, we recorded an immaterial unrealized loss in accumulated other comprehensive income on the consolidated balance sheet.

The following table presents our assets and liabilities that are measured at fair value on a recurring basis at May 31:

	2012		2011	
(dollar amounts in thousands)	Level 1	Level 2	Level 1	Level 2
Derivative assets	$ -	$ 296,036	$ -	$ 343,760
Derivative liabilities	-	654,125	-	477,433
Investments in common stock	1,467	-	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 May 31, 2012 and 2011, we measured certain collateral-dependent non-performing loans at fair value. In certain instances when a loan is non-performing, we utilize the collateral fair value underlying the loan in estimating the specific loan loss allowance. To estimate the fair value of the collateral, we may use third party valuation specialists or we may use internal estimates. The approaches used by both our internal staff and third party specialists include the discounted cash flow, market multiple and replacement cost methods. The material inputs used in estimating the fair value of such collateral, by both internal staff and third party specialists, are level 3 within the fair value hierarchy. In these instances, the valuation is considered to be a non-recurring item. The significant unobservable inputs for Level 3 assets that are valued using fair values obtained from third party specialists are reviewed by our Credit Risk Management group to assess the reasonableness of the assumptions used and the accuracy of the work performed. We use the final unadjusted third party valuation analysis as support for any financial statement adjustments and disclosures to the financial statements. The valuation techniques and significant unobservable inputs for assets classified as Level 3 in the fair value hierarchy, which are measured using an internal model, are independently reviewed by other internal staff.

For assets measured at fair value on a non-recurring basis at May 31, 2012 and 2011 that are classified as Level 3 within the fair value hierarchy, due to the nature and level of unobservable inputs, any increase or decrease to such unobservable inputs used in the determination of fair value, will not have a significant impact on the fair value measurement of those assets or to the results of operations.

Assets measured at fair value on a non-recurring basis at May 31, 2012 and 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 May 31 and the total losses for the years ended May 31:

	Level 3 Fair Value		Total losses	
(dollar amounts in thousands)	2012	2011	2012	2011
Non-performing loans, net of specific reserves	$ 16,517	$ 10,509	$ (3,861)	$ -

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(14) Fair Value of Financial Instruments

Carrying and fair values for our financial instruments are presented as follows at May 31:

	2012		2011	
(dollar amounts in thousands)	Carrying value	Fair value	Carrying value	Fair value
Assets:				
Cash and cash equivalents	$ 191,167	$ 191,167	$ 293,615	$ 293,615
Restricted cash	7,694	7,694	7,690	7,690
Investments in equity securities	59,045	59,045	58,601	58,601
Loans to members, net	18,776,286	20,405,353	19,169,620	19,804,116
Debt service reserve funds	39,803	39,803	45,662	45,662
Interest rate exchange agreements	296,036	296,036	343,760	343,760
Liabilities:				
Short-term debt	4,493,434	4,498,565	5,842,924	5,923,611
Long-term debt	12,151,967	13,936,540	11,293,249	12,700,219
Guarantee liability	28,663	31,518	22,217	25,264
Interest rate exchange agreements	654,125	654,125	477,433	477,433
Subordinated deferrable debt	186,440	187,335	186,440	188,399
Members' subordinated certificates	1,722,744	1,880,558	1,801,212	1,961,005
Off-balance sheet instruments:				
Commitments	-	-	-	-

See Note 13, Fair Value Measurement, for more details on assets and liabilities measured at fair value on a recurring or non-recurring basis on our 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 May 31, 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 May 31, 2012 and 2011.

Cash and Cash Equivalents
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. Cash and cash equivalents are classified within level 1 of the fair value hierarchy.

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. Restricted cash is classified within level 1 of the fair

value hierarchy.

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 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. The common stock is classified within level 1 of the fair value hierarchy.

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. The preferred stock is classified within level 3 of the fair value hierarchy.

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 13, 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.

Loans to members, net are classified within level 3 of the fair value hierarchy.

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. Debt service reserve funds are classified within level 1 of the fair value hierarchy.

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. Short-term debt is classified within level 2 and level 3 of the fair value hierarchy.

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. Long-term debt is classified within level 2 and level 3 of the fair value hierarchy.

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. Guarantees are classified within level 3 of the fair value hierarchy.

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. Subordinated deferrable debt is classified within level 1 of the fair value hierarchy.

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 with CFC's consent. 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. Members' subordinated certificates are classified within level 3 of the fair value hierarchy.

Derivative Instruments
We record derivative instruments in the 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. Derivative instruments are classified within level 2 of the fair value hierarchy.

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. Commitments are classified within level 3 of the fair value hierarchy.

(15) Segment Information

Our consolidated financial statements include the financial results of CFC, entities controlled by CFC (which were created to hold foreclosed assets and facilitate loan securitization transactions), RTFC and NCSC. Separate financial statements are produced for CFC, RTFC and NCSC and are the primary reports that management reviews in evaluating performance. The separate financial statements for CFC represent the consolidation of the financial results for CFC and the entities controlled by CFC. RTFC and NCSC are consolidated as noncontrolling interests based on the accounting standards governing consolidations. For more detail on the requirement to consolidate the financial results of RTFC and NCSC see Note 1, General Information and Accounting Policies.

The consolidated CFC financial statements include three operating segments, CFC, RTFC and NCSC. At May 31, 2012, the RTFC and NCSC operating segments are not required to be separately reported as the financial results of RTFC and NCSC do not meet the quantitative thresholds outlined by the accounting standards for segment reporting. As a result, we have elected to aggregate the RTFC and NCSC financial results into a combined "Other" segment.

RTFC borrows all of its required loan funding from CFC. NCSC also borrows all of its required loan funding from CFC. Pursuant to a guarantee agreement, CFC has agreed to indemnify RTFC and NCSC for loan losses. Thus, CFC maintains the consolidated loan loss allowance.

The following tables contain the segment presentation for the consolidated statements of operations for the years ended May 31, 2012, 2011 and 2010, and consolidated balance sheets at May 31, 2012, 2011 and 2010.

	For the year ended May 31, 2012			
(dollar amounts in thousands)	CFC	Other	Elimination	Consolidated
Statement of operations:				
Interest income	$ 943,450	$ 66,216	$ (48,705)	$ 960,961
Interest expense	(760,155)	(50,331)	48,708	(761,778)
Net interest income	183,295	15,885	3	199,183
Recovery of loan losses	18,108	-	-	18,108
Net interest income after recovery of loan losses	201,403	15,885	3	217,291
Non-interest income:				
Fee and other income	17,926	1,099	(1,276)	17,749
Derivative losses	(222,437)	(14,189)	6	(236,620)
Results of operations from foreclosed assets	(67,497)	-	-	(67,497)
Total non-interest income	(272,008)	(13,090)	(1,270)	(286,368)
Non-interest expense:				
General and administrative expenses	(57,132)	(8,988)	783	(65,337)
Provision for guarantee liability	(726)	-	-	(726)
Loss on early extinguishment of debt	(15,525)	-	-	(15,525)
Other	(739)	(484)	484	(739)
Total non-interest expense	(74,122)	(9,472)	1,267	(82,327)
Loss prior to income taxes	(144,727)	(6,677)	-	(151,404)
Income tax benefit	-	2,607	-	2,607
Net loss	$ (144,727)	$ (4,070)	$ -	$ (148,797)
Assets:				
Total loans outstanding	$ 18,874,548	$ 1,165,845	$ (1,128,651)	$ 18,911,742
Deferred origination costs	7,870	-	-	7,870
Less: Allowance for loan losses	(143,326)	-	-	(143,326)
Loans to members, net	18,739,092	1,165,845	(1,128,651)	18,776,286
Other assets	1,150,766	146,942	(122,659)	1,175,049
Total assets	$ 19,889,858	$ 1,312,787	$ (1,251,310)	$ 19,951,335

	For the year ended May 31, 2011			
(dollar amounts in thousands)	CFC	Other	Elimination	Consolidated
Statement of operations:				
Interest income	$ 986,264	$ 83,305	$ (60,658)	$ 1,008,911
Interest expense	(839,445)	(62,367)	60,732	(841,080)
Net interest income	146,819	20,938	74	167,831
Recovery of loan losses	82,971	39	-	83,010
Net interest income after recovery of loan losses	229,790	20,977	74	250,841
Non-interest income:				
Fee and other income	25,291	1,258	(2,903)	23,646
Derivative (losses) gains	(22,182)	(8,101)	47	(30,236)
Results of operations from foreclosed assets	(15,989)	-	-	(15,989)
Total non-interest income	(12,880)	(6,843)	(2,856)	(22,579)
Non-interest expense:				
General and administrative expenses	(63,218)	(9,677)	1,448	(71,447)
Recovery of guarantee liability	673	-	-	673
Loss on early extinguishment of debt	(3,928)	-	-	(3,928)
Other	(1,011)	(1,341)	1,334	(1,018)
Total non-interest expense	(67,484)	(11,018)	2,782	(75,720)
Income prior to income taxes	149,426	3,116	-	152,542
Income tax expense	-	(1,327)	-	(1,327)
Net income	$ 149,426	$ 1,789	$ -	$ 151,215
Assets:				
Total loans outstanding	$18,912,635	$1,383,197	$ (971,156)	$ 19,324,676
Deferred origination costs	6,121	-	-	6,121
Less: Allowance for loan losses	(161,177)	-	-	(161,177)
Loans to members, net	18,757,579	1,383,197	(971,156)	19,169,620
Other assets	1,371,147	224,510	(203,655)	1,392,002
Total assets	$20,128,726	$1,607,707	$ (1,174,811)	$ 20,561,622

(dollar amounts in thousands)	For the year ended May 31, 2010			
	CFC	Other	Elimination	Consolidated
Statement of operations:				
Interest income	$ 1,022,926	$ 97,595	$ (76,886)	$ 1,043,635
Interest expense	(910,052)	(79,003)	76,944	(912,111)
Net interest income	112,874	18,592	58	131,524
Recovery of loan losses	30,318	97	-	30,415
Net interest income after recovery of loan losses	143,192	18,689	58	161,939
Non-interest income:				
Fee and other income	18,462	1,527	(2,278)	17,711
Settlement income	22,953	-	-	22,953
Derivative (losses) gains	(11,651)	(9,006)	49	(20,608)
Results of operations from foreclosed assets	(5,469)	-	-	(5,469)
Total non-interest income	24,295	(7,479)	(2,229)	14,587
Non-interest expense:				
General and administrative expenses	(61,883)	(11,047)	1,978	(70,952)
Provision for guarantee liability	5,281	-	-	5,281
Other	(573)	(224)	193	(604)
Total non-interest expense	(57,175)	(11,271)	2,171	(66,275)
Income (loss) prior to income taxes	110,312	(61)	-	110,251
Income tax benefit	-	296	-	296
Net income	$ 110,312	$ 235	$ -	$ 110,547
Assets:				
Total loans outstanding	$ 19,097,005	$ 2,023,376	$ (1,781,976)	$ 19,338,405
Deferred origination costs	4,299	-	-	4,299
Less: Allowance for loan losses	(592,746)	(18)	-	(592,764)
Loans to members, net	18,508,558	2,023,358	(1,781,976)	18,749,940
Other assets	1,378,606	211,348	(196,679)	1,393,275
Total assets	$ 19,887,164	$ 2,234,706	$ (1,978,655)	$ 20,143,215

(16) Selected Quarterly Financial Data (Unaudited)

Summarized quarterly financial information for fiscal years 2012 and 2011 are as follows:

	Fiscal Year 2012 Quarters Ended				
(dollar amounts in thousands)	August 31,	November 30,	February 29,	May 31,	Total Year
Interest income	$ 247,250	$ 237,755	$ 238,018	$ 237,938	$ 960,961
Interest expense	(202,044)	(194,680)	(190,294)	(174,760)	(761,778)
Net interest income	45,206	43,075	47,724	63,178	199,183
Recovery of (provision for) loan losses	9,130	2,995	(263)	6,246	18,108
Net interest income after recovery of (provision for) loan losses	54,336	46,070	47,461	69,424	217,291
Non-interest income:					
Derivative losses	(111,571)	(47,753)	(25,563)	(51,733)	(236,620)
Other non-interest income	(5,095)	(2,662)	(40,853)	(1,138)	(49,748)
Total non-interest income	(116,666)	(50,415)	(66,416)	(52,871)	(286,368)
Non-interest expense	(25,993)	(23,356)	(18,346)	(14,632)	(82,327)
(Loss) income prior to income taxes	(88,323)	(27,701)	(37,301)	1,921	(151,404)
Income tax benefit	1,701	407	2	497	2,607
Net (loss) income	(86,622)	(27,294)	(37,299)	2,418	(148,797)
Less: Net loss attributable to noncontrolling interest	2,590	533	56	891	4,070
Net (loss) income attributable to CFC	$ (84,032)	$ (26,761)	$ (37,243)	$ 3,309	$ (144,727)

	Fiscal Year 2011 Quarters Ended				
(dollar amounts in thousands)	August 31,	November 30,	February 28,	May 31,	Total Year
Interest income	$ 251,053	$ 250,518	$ 254,302	$ 253,038	$ 1,008,911
Interest expense	(219,512)	(212,401)	(206,333)	(202,834)	(841,080)
Net interest income	31,541	38,117	47,969	50,204	167,831
Recovery of loan losses	12,288	27,253	3,374	40,095	83,010
Net interest income after recovery of loan losses	43,829	65,370	51,343	90,299	250,841
Non-interest income:					
Derivative (losses) gains	(78,254)	47,311	53,348	(52,641)	(30,236)
Other non-interest income	10,161	1,651	(1,712)	(2,443)	7,657
Total non-interest income	(68,093)	48,962	51,636	(55,084)	(22,579)
Non-interest expense	(20,861)	(21,486)	(16,738)	(16,635)	(75,720)
(Loss) income prior to income taxes	(45,125)	92,846	86,241	18,580	152,542
Income tax benefit (expense)	2,780	(2,174)	(2,589)	656	(1,327)
Net (loss) income	(42,345)	90,672	83,652	19,236	151,215
Less: Net loss (income) attributable to noncontrolling interest	5,149	(3,225)	(4,315)	602	(1,789)
Net (loss) income attributable to CFC	$ (37,196)	$ 87,447	$ 79,337	$ 19,838	$ 149,426

(17) Subsequent Events

Subsequent to May 31, 2012, we borrowed $255 million under our committed loan facilities with the Federal Financing Bank.