

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORP /DC/  
Form 10-Q  
January 14, 2011

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended November 30, 2010

OR

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

Commission File Number 1-7102

NATIONAL RURAL UTILITIES COOPERATIVE  
FINANCE CORPORATION

(Exact name of registrant as specified in its charter)

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

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

2201 COOPERATIVE WAY, HERNDON, VA 20171  
(Address of principal executive offices)  
(Registrant's telephone number, including area code, is 703-709-6700)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer                       Accelerated filer                       Non-accelerated filer                       Smaller reporting company

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

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

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## PART 1. FINANCIAL INFORMATION

## Item 1. Financial Statements.

## NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

## CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(in thousands)

## A S S E T S

	November 30, 2010	May 31, 2010
Cash and cash equivalents	\$ 338,671}	\$ 513,906
Restricted cash	11,717}	15,709
Investments in equity securities	58,504}	58,607
Loans to members	19,142,840}	19,342,704
Less: Allowance for loan losses	(225,546)	(592,764)
Loans to members, net	18,917,294}	18,749,940
Accrued interest and other receivables	206,250}	216,650
Fixed assets, net	64,995}	55,682
Debt service reserve funds	45,662}	45,662
Debt issuance costs, net	42,167}	46,562
Foreclosed assets, net	254,993}	42,252
Derivative assets	419,535}	373,203
Other assets	21,696}	25,042
	\$ 20,381,484}	\$ 20,143,215

See accompanying notes.



## NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

## CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(in thousands)

## LIABILITIES AND EQUITY

	November 30, 2010	May 31, 2010
Short-term debt	\$ 4,417,722}	\$ 4,606,361
Accrued interest payable	204,819}	214,072
Long-term debt	12,579,129}	12,054,497
Deferred income	17,317}	17,001
Guarantee liability	22,609}	22,984
Other liabilities	34,866}	36,553
Derivative liabilities	555,597}	482,825
Subordinated deferrable debt	186,440}	311,440
Members' subordinated certificates:		
Membership subordinated certificates	643,083}	643,211
Loan and guarantee subordinated certificates	738,752}	769,654
Member capital securities	397,850}	397,850
Total members' subordinated certificates	1,779,685}	1,810,715
Commitments and contingencies		
CFC equity:		
Retained equity	567,501}	568,577
Accumulated other comprehensive income	7,567}	8,004
Total CFC equity	575,068}	576,581
Noncontrolling interest	8,232}	10,186
Total equity	583,300}	586,767
	\$ 20,381,484}	\$ 20,143,215

See accompanying notes.

## NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

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

	For the three months ended November 30,		For the six months ended November 30,	
	2010	2009	2010	2009
Interest income	\$ 250,518}	\$ 264,919	\$ 501,571}	\$ 534,376
Interest expense	(212,401)	(226,977)	(431,913)	(469,606)
Net interest income	38,117}	37,942	69,658}	64,770
Recovery of (provision for) loan losses	27,253}	(1,577)	39,541}	14,594
Net interest income after recovery of (provision for) loan losses	65,370}	36,365	109,199}	79,364
Non-interest income:				
Fee and other income	4,844}	4,106	15,136}	7,840
Derivative gains (losses)	47,311}	(3,144)	(30,943)	(17,472)
Results of operations of foreclosed assets	(1,653)	21	(1,469)	608
Total non-interest income	50,502}	983	(17,276)	(9,024)
Non-interest expense:				
Salaries and employee benefits	(9,694)	(9,766)	(22,720)	(19,684)
Other general and administrative expenses	(7,567)	)	(15,854)	)
(Provision for) recovery of guarantee liability	(166)	(6,650)	382}	(13,758)
Market adjustment on foreclosed assets	(1,540)	821	(1,855)	3,216
Loss on early extinguishment of debt	(3,928)	-	(3,928)	)
Other	(131)	-	(3,928)	(1,750)
Total non-interest expense	(23,026)	(175)	(44,202)	(32,297)
Income prior to income taxes	92,846}	21,578	47,721}	38,043
Income tax (expense) benefit	(2,174)	841	606}	809
Net income	90,672}	22,419	48,327}	38,852

Less: Net (income) loss attributable to the noncontrolling interest	(3,225)	1,568	1,924}	1,377
Net income attributable to CFC	\$ 87,447}	\$ 23,987	\$ 50,251}	\$ 40,229

See accompanying notes.



## NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

## CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(UNAUDITED)

(in thousands)

	Total	Noncontrolling Interest	Total CFC Equity	Accumulated Other Comprehensive Income	CFC Retained Equity	Unallocated Net Loss	Members' Capital Reserve	Patronage Cap Allo
Balance as of May 31, 2010	\$ 586,767}	\$ 10,186}	\$ 576,581}	\$ 8,004}	\$ 568,577}	\$ (106,984)	\$ 191,993}	\$ 481,
Patronage capital retirement	(50,907)	-}	(50,907)	-}	(50,907)	-}	-}	(50,
Net income (loss)	48,327}	(1,924)	50,251}	-}	50,251}	50,251}	-}	
Other comprehensive loss	(451)	(14)	(437)	(437)	-}	-}	-}	
Total comprehensive income	47,876}	(1,938)	49,814}					
Other	(436)	(16)	(420)	-}	(420)	-}	-}	
Balance as of November 30, 2010	\$ 583,300}	\$ 8,232}	\$ 575,068}	\$ 7,567}	\$ 567,501}	\$ (56,733)	\$ 191,993}	\$ 430,

See accompanying notes.

## NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

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

	For the six months ended November 30,	
	2010	2009
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 48,327}	\$ 38,852
Adjustments to reconcile net income to net cash provided by operating activities		
Amortization of deferred income	(3,947)	(3,087)
Amortization of debt issuance costs and deferred charges	10,116}	10,842
Depreciation	1,115}	1,069
Recovery of loan losses	(39,541)	(14,594)
Recovery of guarantee liability	(382)	(3,216)
Results of operations of foreclosed assets	1,469}	(608)
Market adjustment on foreclosed assets	1,855}	1,750
Derivative forward value	26,108}	3,272
Changes in operating assets and liabilities:		
Accrued interest and other receivables	7,005}	25,375
Accrued interest payable	(9,253)	(23,062)
Other	3,503}	(3,382)
 Net cash provided by operating activities	 46,375}	 33,211
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Advances made on loans	(4,434,409)	(3,781,896)
Principal collected on loans	3,979,481}	4,212,578
Net investment in fixed assets	(10,428)	(6,750)
Proceeds from foreclosed assets	29,303}	-
Investments in foreclosed assets	(116,887)	-
Net proceeds from sale of loans	198,062}	28,626
Investments in equity securities	(24)	(26,089)
Change in restricted cash	3,992}	(9,391)
 Net cash (used in) provided by investing activities	 (350,910)	 417,078
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
	631,016}	(237,818)

Proceeds from issuances (repayments) of short-term debt, net		
Proceeds from issuance of long-term debt, net	1,484,066}	1,502,215
Payments for retirement of long-term debt	(1,798,671)	(1,885,195)
Payments for retirement of subordinated deferrable debt	(125,000)	-
Proceeds from issuance of members' subordinated certificates	8,452}	103,262
Payments for retirement of members' subordinated certificates	(23,056)	(38,524)
Payments for retirement of patronage capital	(47,507)	(43,328)
Net cash provided by (used in) financing activities	129,300}	(599,388)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(175,235)	(149,099)
BEGINNING CASH AND CASH EQUIVALENTS	513,906}	504,999
ENDING CASH AND CASH EQUIVALENTS	\$ 338,671}	\$ 355,900

See accompanying notes.

## NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

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

	For the six months ended	
	November 30,	
	2010	2009
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash paid for interest	\$ 431,050	\$ 481,827
Cash paid for income taxes (1)	439	206
 Non-cash financing and investing activities:		
Subordinated certificates applied against loan balances	\$ 174	\$ -
Patronage capital applied against loan balances	104	-
Fair value of foreclosed assets applied as repayment of loans	128,130	-
Charge-offs of allowance for loan losses applied against loan balances	327,799	-
Net decrease in debt service reserve funds/debt service reserve certificates	-	(4,673)
 (1) Relates to income taxes paid for National Cooperative Services Corporation.		

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

(1) General Information and Accounting Policies

(a) Basis of Presentation

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

Unless stated otherwise, references to “we,” “our” or “us” represent the consolidation of CFC, RTFC, NCSC and certain entities controlled by CFC to hold foreclosed assets and to accommodate loan securitization transactions.

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.

These interim unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended May 31, 2010.

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

(b) Variable Interest Entities

We are required to consolidate the financial results of RTFC and NCSC because CFC is the primary beneficiary of variable interests in RTFC and NCSC due to its exposure to absorbing the majority of their expected losses and because CFC manages the lending activities of RTFC and NCSC. Under separate guarantee agreements, RTFC and NCSC pay CFC a fee to indemnify against loan losses, excluding losses in NCSC’s consumer loan program. CFC manages the lending activities of RTFC and NCSC through separate management agreements. Additionally, CFC is the sole lender to RTFC and the primary source of funding to NCSC. NCSC funds its lending programs either through loans from CFC or commercial paper and long-term notes issued by NCSC and guaranteed by 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 November 30, 2010, CFC had guaranteed \$471 million of NCSC debt, derivative instruments and guarantees with third parties, and CFC’s maximum potential exposure for these instruments totaled \$484 million. The maturities for NCSC obligations guaranteed by CFC run through 2031. Guarantees of NCSC debt and derivative instruments are not included in Note 9, Guarantees, as the debt and derivatives are reported on the condensed consolidated balance sheet.

At November 30, 2010, CFC guaranteed \$0.8 million of RTFC guarantees with third parties. The maturities for RTFC obligations guaranteed by CFC run through 2012. All CFC loans to RTFC and NCSC are secured by all assets and revenue of RTFC and NCSC. At November 30, 2010, RTFC had total assets of \$1,125 million including loans outstanding to members of \$955 million, and NCSC had total assets of \$546 million including loans outstanding of \$493 million. At November 30, 2010, CFC had committed to lend RTFC up to \$4,000 million, of which \$943 million was outstanding. At November 30, 2010, CFC had committed to provide up to \$2,000 million of credit to NCSC, of which \$598 million was outstanding, representing \$127 million of outstanding loans and \$471 million of credit enhancements.

(c) 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, 2010. Derivative forward value gain totaling \$8 million and derivative forward value loss totaling \$3 million for the three and six months ended November 30, 2009, respectively, have been reclassified to derivative gains (losses) in non-interest income on the condensed consolidated statements of operations. Derivative cash settlements expense totaling \$11 million and \$14 million for the three and six months ended November 30, 2009,

respectively, have been reclassified to derivative gains (losses) in non-interest income on the consolidated statement of operations. The derivative forward value was classified in non-interest expense and the derivative cash settlements were classified in non-interest income in the November 30, 2009 10-Q. These reclassifications were made to present the unrealized and realized gains and losses on our derivatives in the same line on the statement of operations.

(d) Interest Income

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

	For the three months ended November 30,		For the six months ended November 30,	
(dollar amounts in thousands)	2010	2009	2010	2009
Interest on long-term fixed-rate loans (1)	\$ 226,397}	\$ 225,550	\$ 449,366}	\$ 449,076
Interest on long-term variable-rate loans (1)	11,345}	21,686	24,001}	48,251
Interest on short-term loans (1)	10,346}	14,641	22,323}	30,676
Interest on investments (2)	1,004}	1,329	2,034}	2,986
Fee income	1,426}	1,713	3,847}	3,387
Total interest income	\$ 250,518}	\$ 264,919	\$ 501,571}	\$ 534,376

(1) Represents interest income on loans to members.

(2) Represents interest income on the investment of cash, debt securities and equity securities.

Deferred income on the condensed consolidated balance sheets primarily includes deferred conversion fees totaling \$12 million at November 30, 2010 and May 31, 2010.

(e) Interest Expense

The following table presents the components of interest expense:

	For the three months ended November 30,		For the six months ended November 30,	
(dollar amounts in thousands)	2010	2009	2010	2009
Interest expense on debt (1):				
Commercial paper and bank bid notes	\$ 2,286}	\$ 1,964	\$ 4,009}	\$ 5,186
Medium-term notes	61,096}	65,902	124,200}	150,497
Collateral trust bonds	75,247}	81,585	153,796}	160,178
Subordinated deferrable debt	2,830}	4,915	7,746}	9,831
Subordinated certificates	20,218}	19,787	40,524}	38,807
Long-term private debt	45,632}	47,568	91,624}	93,554
Debt issuance costs (2)	2,541}	2,625	5,118}	5,605
Fee expense (3)	2,551}	2,631	4,896}	5,948
Total interest expense	\$ 212,401}	\$ 226,977	\$ 431,913}	\$ 469,606

(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 underwriter's fees, legal fees, printing costs and comfort letter fees. Amortization is calculated using the effective interest method. Also includes issuance costs related to dealer commercial paper, which are recognized as incurred.

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

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

(f) Loan Sales

During the six months ended November 30, 2010, we sold distribution and power supply loans with outstanding principal balances totaling \$198 million at par to the Federal Agricultural Mortgage Corporation for cash. We recorded a loss on sale of loans totaling \$0.07 million, representing the unamortized deferred loan origination costs and transaction costs for the loans sold during the six months ended November 30, 2010. We do not hold any continuing interest in the loans sold and have no obligation to repurchase loans from the purchaser; however, we retain the servicing obligations on these loans in return for a market-based fee. As a result, we did not record a servicing asset or liability.

(g) New Accounting Pronouncements

During the six months ended November 30, 2010, we did not change or adopt any new accounting policies that had a material effect on our consolidated financial condition or results of operations.



## (2) Loans and Commitments

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

	November 30, 2010		May 31, 2010	
	Loans Outstanding	Unadvanced Commitments (1)	Loans Outstanding	Unadvanced Commitments (1)
(dollar amounts in thousands)				
Total by loan type (2) (3):				
Long-term fixed-rate loans (1)	\$ 16,246,206}	\$ -}	\$ 15,412,987	\$ -
Long-term variable-rate loans	1,337,656}	5,366,730}	2,088,829	5,154,990
(1)				
Loans guaranteed by RUS (4)	228,877}	-}	237,356	-
Short-term loans	1,324,470}	8,860,980}	1,599,233	9,039,448
Total loans outstanding	19,137,209}	14,227,710}	19,338,405	14,194,438
Deferred origination costs	5,631}	-}	4,299	-
Less: Allowance for loan losses	(225,546)	-}	(592,764)	-
Net loans outstanding	\$ 18,917,294}	\$ 14,227,710}	\$ 18,749,940	\$ 14,194,438
Total by segment (2):				
CFC:				
Distribution	\$ 13,993,120}	\$ 9,554,979}	\$ 13,459,053	\$ 9,536,360
Power supply	3,604,022}	3,667,087}	3,769,794	3,599,560
Statewide and associate	91,628}	113,629}	86,182	112,812
CFC total	17,688,770}	13,335,695}	17,315,029	13,248,732
RTFC	955,411}	390,810}	1,671,893	441,719
NCSC	493,028}	501,205}	351,483	503,987
Total loans outstanding	\$ 19,137,209}	\$ 14,227,710}	\$ 19,338,405	\$ 14,194,438

(1) Before advancing funds, additional information may be required to assure that all conditions for the advance of funds have been fully met and there has been no material change in the member's condition as represented in the supporting documents. Collateral and security requirements for advances on commitments are identical to those required at the time of the initial loan approval. Because the interest rate on unadvanced commitments is not set until drawn, 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) Loans are classified as long-term or short-term based on their original maturity.

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

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

	November 30, 2010		May 31, 2010	
	Loans Outstanding	Unadvanced Commitments (1)	Loans Outstanding	Unadvanced Commitments (1)
(dollar amounts in thousands)				

Non-performing and restructured loans:

## Non-performing loans (2):

## CFC:

Long-term variable-rate loans	\$ 8,194}	\$ -}	\$ 8,500	\$ -
Short-term loans	18,256}	-}	16,000	-

## RTFC:

Long-term fixed-rate loans (1)	5,109}	-}	8,960	-
Long-term variable-rate loans (1)	68,202}	-}	469,596	677
Short-term loans	1,500}	-}	57,471	-
Total non-performing loans	\$ 101,261}	\$ -}	\$ 560,527	\$ 677

## Restructured loans (2):

## CFC:

Long-term fixed-rate loans (1)	\$ 40,611}	\$ -}}	\$ 41,538	\$ -
Long-term variable-rate loans (1)	448,183}	140,755}}	462,397	140,755
Short-term loans	-}	12,500}}	-	12,500

## RTFC:

Long-term fixed-rate loans	-}	-}}	3,293	-
Long-term variable-rate loans	-}	-}}	816	-
Total restructured loans	\$ 488,794}	\$ 153,255}}	\$ 508,044	\$ 153,255

(1) Before advancing funds, additional information may be required to assure that all conditions for the advance of funds have been fully met and there has been no material change in the member's condition as represented in the supporting documents. Collateral and security requirements for advances on commitments are identical to those required at the time of the initial loan approval. Because the interest rate on unadvanced commitments is not set until drawn, 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) Loans are classified as long-term or short-term based on their original maturity.

On October 6, 2010, CFC took control of the United States Virgin Islands (“USVI”) operating entities of Innovative Communications Corporation (“ICC”). This resulted in a reduction of \$472 million to the RTFC non-performing loan balance for ICC at November 30, 2010. See further discussion in Note 3, Foreclosed Assets and Note 12, Restructured/Non-Performing Loans and Contingencies.

#### 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.

Activity in the loan loss allowance account is summarized below:

(dollar amounts in thousands)	As of and for the three months ended November 30,		As of and for the six months ended November 30,	
	2010	2009	2010	2009
Balance at beginning of period	\$ 580,539}	\$ 606,839	\$ 592,764}	\$ 622,960
(Recovery of) provision for loan losses	(27,253)	1,577	(39,541)	(14,594)
Charge-offs	(327,808)	(33)	(327,817)	(56)
Recoveries	68}	75	140}	148
Balance at end of period	\$ 225,546}	\$ 608,458	\$ 225,546}	\$ 608,458
As a percentage of total loans outstanding	1.18}%	3.08 %	1.18}%	3.08 %

In October 2010, the transfer of control of the USVI entities of ICC was completed resulting in a \$328 million principal charge-off on the outstanding loans to ICC. See further discussion in Note 3, Foreclosed Assets and Note 12, Restructured/Non-Performing Loans and Contingencies.

#### Loan Security

Except when providing short-term 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. Short-term loans are generally unsecured lines of credit. 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 tables summarize our secured and unsecured loans outstanding by loan type and by segment:

(dollar amounts in thousands)	November 30, 2010				May 31, 2010			
	Secured	%	Unsecured	%	Secured	%	Unsecured	%
Total by loan type:								
Long-term fixed-rate loans	\$ 15,454,403}	95%	\$ 791,803}	%	\$ 14,799,859	96%	\$ 613,128}	%
Long-term variable-rate loans	1,241,949}	93	95,707}	7	1,994,664	95	94,165}	5
Loans guaranteed by RUS	228,877}	100	-}	-	237,356	100	-}	-
Short-term loans	68,360}	5	1,256,110}	95	265,427	17	1,333,806}	83
Total loans	\$ 16,993,589}	89	\$ 2,143,620}	11	\$ 17,297,306	89	\$ 2,041,099}	11

Total by segment:

CFC	\$ 15,950,874}	90%	\$ 1,737,896}	10%	\$ 15,585,788	90%	\$ 1,729,241}	10%
RTFC	720,214}	75	235,197}	25	1,429,982	86	241,911}	14
NCSC	322,501}	65	170,527}	35	281,536	80	69,947}	20
Total loans	\$ 16,993,589}	89	\$ 2,143,620}	11	\$ 17,297,306	89	\$ 2,041,099}	11

## Pledging of Loans and Loans on Deposit

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

(dollar amounts in thousands)	November 30, 2010	May 31, 2010
Collateral trust bonds:		
2007 indenture		
Distribution system mortgage notes	\$ 4,248,065 }	\$ 3,951,445
Collateral trust bonds outstanding	3,750,000 }	3,500,000
1994 indenture		
Distribution system mortgage notes	\$ 1,878,987 }	\$ 2,081,716
RUS guaranteed loans qualifying as permitted investments	201,387 }	207,136
Total pledged collateral	\$ 2,080,374 }	\$ 2,288,852
Collateral trust bonds outstanding	1,475,000 }	1,980,000
1972 indenture		
Cash	\$ - }	\$ 2,032
Collateral trust bonds outstanding	- }	1,736
Federal Agricultural Mortgage Corporation:		
Distribution and power supply system mortgage notes	\$ 2,233,003 }	\$ 2,094,604
Notes payable outstanding	1,887,200 }	1,587,200
Clean Renewable Energy Bonds Series 2009A:		
Distribution and power supply system mortgage notes	\$ 35,550 }	\$ 33,895
Cash	10,945 }	12,913
Total pledged collateral	\$ 46,495 }	\$ 46,808
Notes payable outstanding	27,101 }	27,101

The following table shows the collateral on deposit and the amount of the corresponding debt outstanding for the notes payable to the Federal Financing Bank of the United States Treasury issued under the Guaranteed Underwriter program of the U.S. Department of Agriculture, which supports the Rural Economic Development Loan and Grant program (see Note 5, Long-Term Debt):

(dollar amounts in thousands)	November 30, 2010	May 31, 2010
Distribution and power supply system mortgage notes on deposit	\$ 3,464,726 }	\$ 3,559,863
Notes payable	3,000,000 }	3,000,000

## (3) 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 condensed consolidated balance sheets as foreclosed assets. These assets do not meet the criteria to be classified as held for sale at November 30, 2010 and May 31, 2010.

The activity for foreclosed assets is summarized below:

(dollar amounts in thousands)	As of and for the three months ended November 30,		As of and for the six months ended November 30,	
	2010	2009	2010	2009
Beginning balance	\$ 38,121}	\$ 47,558	\$ 42,252}	\$ 48,721
Results of operations	(1,653)	21	(1,469)	608
Initial investment in USVI entities	216,401}	-	216,401}	-
Net cash invested in (provided by) foreclosed assets	3,664}	-	(336)	-
Market adjustment	(1,540)	-	(1,855)	(1,750)
Ending balance	\$ 254,993}	\$ 47,579	\$ 254,993}	\$ 47,579

At November 30, 2010, foreclosed assets includes two subsidiaries controlled by CFC to hold foreclosed assets. One subsidiary 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. The other subsidiary holds our investment in cable and telecommunications entities located in the USVI.

On October 6, 2010, CFC, through RTFC, completed the transfer of control of 100 percent of the equity interests of ICC's USVI operating entities as partial satisfaction of RTFC loans to ICC resulting from the transfer of ICC's assets in bankruptcy. ICC is a diversified telecommunications company headquartered in St. Croix, USVI. RTFC has assigned to CFC its rights with respect to the entities transferred as partial satisfaction of its loan from CFC.

CFC recorded an initial investment of \$216 million to foreclosed assets comprised of the \$128 million fair value for the entities transferred and an additional investment of \$88 million in these entities to pay down or settle third-party obligations outstanding prior to the transfer. At November 30, 2010, our investment in USVI entities was \$218 million. The results of operations from foreclosed assets includes a \$2 million net loss representing the ongoing results of operations for the USVI entities from October 6, 2010 through November 30, 2010.

The purchase accounting method was used to account for the transfer of control of ICC's USVI entities to CFC. The purchase price of \$128 million was based on the enterprise value of the USVI entities, less debt obligations, plus cash received as part of the transfer of control on the closing date. The second step in the process, estimating the fair value of the assets and liabilities at each entity transferred, requires significant estimates and assumptions and was not completed prior to the filing of this report. Changes to the estimated fair values are subject to adjustment as additional information is obtained. Adjustments required to the purchase price and the fair value of the assets and liabilities at each entity will be recorded in the period in which the new information is obtained or the analysis is completed. However, the period for adjustments will not exceed one year from the date of transfer.

The USVI 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.

During the first quarter of fiscal year 2011, we foreclosed on one of the land development loans included in foreclosed assets at May 31, 2010, and took ownership of the underlying assets. Additionally, we sold collateral for the remaining land development loan for \$4 million, net of estimated closing costs. This land development loan was classified as impaired and on non-accrual status with regard to the recognition of interest income at November 30, 2010 and May 31, 2010. During the three and six months ended November 30, 2010, we recorded market adjustments for losses on land development loans held as foreclosed assets of \$1.5 million and \$1.9 million, respectively.

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

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

(dollar amounts in thousands)	November 30, 2010	May 31, 2010
Short-term debt:		
Commercial paper sold through dealers, net of discounts	\$ 920,265 }	\$ 840,082
Commercial paper sold directly to members, at par	1,242,947 }	999,449
Commercial paper sold directly to non-members, at par	51,227 }	52,989
Total commercial paper	2,214,439 }	1,892,520
Daily liquidity fund sold directly to members	440,807 }	371,710
Bank bid notes	270,000 }	30,000
Subtotal short-term debt	2,925,246 }	2,294,230
Long-term debt maturing within one year:		
Medium-term notes sold through dealers	543,279 }	693,522
Medium-term notes sold to members	449,855 }	529,215
Secured collateral trust bonds	5,000 }	906,537
Members' subordinated certificates	11,477 }	-
Secured notes payable	478,207 }	178,207
Unsecured notes payable	4,658 }	4,650
Total long-term debt maturing within one year	1,492,476 }	2,312,131
Total short-term debt	\$ 4,417,722 }	\$ 4,606,361

## Revolving Credit Agreements

The following is a summary of the amounts available under our revolving credit agreements:

(dollar amounts in thousands)	November 30, 2010	May 31, 2010	Termination Date	Facility fee per year (1)
Five-year agreement	\$ 1,049,000	\$ 1,049,000	March 16, 2012	6 basis points
Five-year agreement	967,313	967,313	March 22, 2011	6 basis points
Three-year agreement (2)	1,369,919	1,334,309	March 8, 2013	25 basis points
Total	\$ 3,386,232	\$ 3,350,622		

(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.

(2) The available amount presented at November 30, 2010 and May 31, 2010, is reduced by total letters of credit outstanding of \$15.1 million and \$0.7 million, respectively.

Effective November 15, 2010, we exercised our right to increase the aggregate amount of the commitment under the three-year revolving credit agreement by \$50 million to a total of \$1,385 million.

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



	Requirement	November 30, 2010	Actual May 31, 2010
Minimum average adjusted TIER over the six most recent fiscal quarters (1)	1.025	1.13	1.25
Minimum adjusted TIER for the most recent fiscal year (1) (2)	1.05	1.12	1.12
Maximum ratio of senior debt to total equity	10.00	6.55	6.15

(1) "TIER" represents the times interest earned ratio.

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

At November 30, 2010 and May 31, 2010, we were in compliance with all covenants and conditions under our revolving credit agreements and there were no borrowings outstanding under these agreements.

## (5) Long-Term Debt

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

(dollar amounts in thousands)	November 30, 2010	May 31, 2010
Unsecured long-term debt:		
Medium-term notes sold through dealers	\$ 2,794,559}	\$ 2,905,332
Medium-term notes sold to members	94,829}	105,186
Subtotal	2,889,388}	3,010,518
Unamortized discount	(2,004)	(2,390)
Total unsecured medium-term notes	2,887,384}	3,008,128
Unsecured notes payable	3,049,047}	3,049,047
Unamortized discount	(1,383)	(1,480)
Total unsecured notes payable	3,047,664}	3,047,567
Total unsecured long-term debt	5,935,048}	6,055,695
Secured long-term debt:		
Collateral trust bonds	5,220,000}	4,575,000
Unamortized discount	(12,013)	(12,292)
Total secured collateral trust bonds	5,207,987}	4,562,708
Secured notes payable	1,436,094}	1,436,094
Total secured long-term debt	6,644,081}	5,998,802
Total long-term debt	\$ 12,579,129}	\$ 12,054,497

In November 2010, we issued \$300 million of 1.125 percent collateral trust bonds due 2013 and \$350 million of 1.900 percent collateral trust bonds due 2015.

Secured notes payable includes debt issued to the Federal Agricultural Mortgage Corporation. Amounts outstanding and available under each note purchase agreement are summarized below:

(dollar amounts in thousands)	Note Purchase	Amount Outstanding	November 30, 2010	May 31, 2010
Note Purchase Agreement	Final Maturity Date	Agreement Amount		
December 2008 (1)	December 31, 2015	\$ 500,000	\$ 500,000	\$ 350,000
February 2009	February 29, 2016	500,000	500,000	500,000
March 2009 (2)	April 1, 2014	400,000	312,200	312,200
May 2009 (3)	December 31, 2016	1,000,000	575,000	425,000
Total		\$ 2,400,000	\$ 1,887,200	\$ 1,587,200

(1) Includes \$250 million and \$100 million of secured notes payable under this program that were classified as short-term debt at November 30, 2010 and May 31, 2010, respectively.

(2) Includes \$76.4 million of secured notes payable under this program that were classified as short-term debt at November 30, 2010 and May 31, 2010.

(3) Includes \$150 million of secured notes payable under this program that were classified as short-term debt at November 30, 2010.

In September 2010 and October 2010, we issued notes totaling \$400 million under our December 2008 and May 2009 note purchase agreements with the Federal Agricultural Mortgage Corporation as follows:

- \$250 million two-month note at a fixed interest rate of 0.65 percent. In November 2010, this amount was refinanced with \$250 million of two-month notes at a fixed interest rate of 0.62 percent; and
  - \$150 million four-month note at a fixed interest rate of 0.67 percent.

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 Rural Economic Development Loan and Grant program. Under this facility, CFC is able to borrow up to the committed amount any time before October 15, 2013, with each advance having a final maturity not longer than 20 years from the advance date.

## (6) Subordinated Deferrable Debt

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

(dollar amounts in thousands)	November 30, 2010	May 31, 2010
NRN 6.75% due 2043 (1)	\$ -	\$ 125,000
NRC 6.10% due 2044	88,201	88,201
NRU 5.95% due 2045	98,239	98,239
Total	\$ 186,440	\$ 311,440

(1) Amount outstanding at May 31, 2010 was redeemed in September 2010.

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

The \$125 million of Series NRN due 2043 was redeemed at par on September 1, 2010. We recorded a \$4 million loss on extinguishment of debt during the second quarter of fiscal year 2011 for the unamortized issuance costs.

## (7) Derivative Financial Instruments

We utilize derivatives such as interest rate swaps and cross-currency interest rate swaps to mitigate interest rate risk and foreign currency exchange risk. We are neither a dealer nor a trader in derivative financial instruments. At November 30, 2010 and May 31, 2010, we did not have any derivative instruments that were accounted for using hedge accounting.

## Interest Rate Swaps

The following table shows the notional amounts outstanding for our interest rate swaps by type:

(dollar amounts in thousands)	November 30, 2010	May 31, 2010
Pay fixed/receive variable	\$ 5,895,215	\$ 5,562,247
Pay variable/receive fixed	5,551,440	5,551,440
Total interest rate swaps	\$ 11,446,655	\$ 11,113,687

Income and losses recorded on the condensed consolidated statements of operations for our interest rate swaps are summarized below:

(dollar amounts in thousands)	For the three months ended November 30,		For the six months ended November 30,	
	2010	2009	2010	2009
Agreements that do not qualify for hedge accounting				
Derivative cash settlements (1)	\$ (373)	\$ (10,706)	\$ (4,835)	\$ (14,200)
Derivative forward value	47,684	7,562	(26,108)	(3,272)
Derivative gains	\$ 47,311	\$ (3,144)	\$ (30,943)	\$ (17,472)

(losses)

(1) The six months ended November 30, 2010 includes a \$3 million fee we paid to terminate an interest rate swap that match funded an RTFC loan that was prepaid during the period.

### Rating Triggers

Some of our interest rate swaps have credit risk-related contingent features referred to as rating triggers. Rating triggers are not separate financial instruments and are not required to be accounted for separately as derivatives. At November 30, 2010, 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 November 30, 2010, our senior unsecured credit rating from Moody's Investors Service and Standard & Poor's Corporation was A2 and A, respectively. At November 30, 2010, 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)	\$ 1,455,136}	\$ (568)	\$ 27,311}	\$ 26,743}
fall below Baa1/BBB+ (1)	6,951,250}	(122,654)	28,169}	(94,485)
Total	\$ 8,406,386}	\$ (123,222)	\$ 55,480}	\$ (67,742)

(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 November 30, 2010, we had a total notional amount of \$868 million of derivative instruments with one counterparty that would require the pledging of collateral totaling \$22 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 November 30, 2010, was \$142 million.

(8) Equity

In July 2010, CFC's Board of Directors authorized the allocation of the fiscal year 2010 net earnings as follows: \$1 million to the cooperative educational fund, \$102 million to members in the form of patronage capital and \$5 million to the members' capital reserve. In July 2010, CFC's Board of Directors authorized the retirement of allocated net earnings totaling \$51 million, representing 50 percent of the fiscal year 2010 allocation. This amount was returned to members in cash in September 2010. Future allocations and retirements of net earnings may be made annually as determined by CFC's Board of Directors with due regard for its financial condition. CFC's Board of Directors has the authority to change the current practice for allocating and retiring net earnings at any time, subject to applicable laws and regulations.

(9) Guarantees

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 in 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 based upon a payment default by a member system.

The following table summarizes total guarantees by type and segment:

(dollar amounts in thousands)	November 30, 2010	May 31, 2010
Total by type:		
Long-term tax-exempt bonds	\$ 582,265	\$ 601,625
Indemnifications of tax benefit transfers	65,991	69,982
Letters of credit	388,355	380,076
Other guarantees	118,328	119,426
Total	\$ 1,154,939	\$ 1,171,109
Total by segment:		
CFC:		
Distribution	\$ 231,415	\$ 221,903
Power supply	848,968	884,828

Statewide and associate	21,189}	22,032
CFC total	1,101,572}	1,128,763
RTFC	821}	636
NCSC	52,546}	41,710
Total	\$ 1,154,939}	\$ 1,171,109

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 November 30, 2010, our maximum potential exposure for the \$52 million of fixed-rate tax-exempt bonds is \$82 million, representing principal and interest. 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. See below for further information about this type of guarantee. Many of these bonds have a call provision that in the event of a default would allow us to trigger the call provision. This would limit our exposure to future interest payments on these bonds. Our maximum potential exposure is secured by a mortgage lien on all of the system's assets and future revenues. 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.

Of the amounts shown in the table above, \$531 million and \$549 million as of November 30, 2010 and May 31, 2010, respectively, are adjustable or floating/fixed-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.

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 revenues. The remainder would be treated as a short-term loan secured by a subordinated mortgage on substantially all of the member's property. Due to changes in federal tax law, no further guarantees of this nature are anticipated.

The maturities for letters of credit run through calendar year 2024. Additionally, letters of credit totaling \$9 million at November 30, 2010 have a term of one year and automatically extend for a period of one year unless we cancel the agreement within 120 days of maturity (in which case, the beneficiary may draw on the letter of credit). The amounts shown in the table above represent our maximum potential exposure, of which \$192 million is secured, at November 30, 2010. When taking into consideration reimbursement obligation agreements that we have in place with other lenders, our maximum potential exposure related to \$34 million of letters of credit would be reduced to \$10 million in the event of default. 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 letter of credit facilities, we may be required to issue up to an additional \$653 million in letters of credit to third parties for the benefit of our members at November 30, 2010. At May 31, 2010, this amount was \$502 million.

The maturities for other guarantees run through calendar year 2025. The maximum potential exposure for these guarantees is \$120 million, all of which is unsecured.

At November 30, 2010 and May 31, 2010, we had a total of \$315 million and \$320 million of guarantees, respectively, representing 27 percent of total guarantees, under which our right of recovery from our members was not secured.

#### Guarantee Liability

At November 30, 2010 and May 31, 2010, we recorded a guarantee liability of \$23 million, which represents the contingent and non-contingent exposures related to guarantees and liquidity obligations associated with members' debt. The contingent guarantee liability at November 30, 2010 and May 31, 2010, was \$6 million based on management's estimate of exposure to losses within the guarantee portfolio. We use factors such as internal risk rating, remaining term of guarantee, corporate bond default probabilities and estimated recovery rates in estimating our contingent exposure. The remaining balance of the total guarantee liability of \$17 million at November 30, 2010 and May 31, 2010 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. The non-contingent obligation is estimated based on guarantee and liquidity fees collectible over the life of the guarantee. The fees are deferred and amortized using the straight-line method into interest income over the term of the guarantees.

Activity in the guarantee liability account is summarized below:

As of and for the

As of and for the



(dollar amounts in thousands)	three months ended		six months ended November	
	November 30,		30,	
	2010	2009	2010	2009
Beginning balance	\$ 22,102}	\$ 26,536	\$ 22,984}	\$ 29,672
Net change in non-contingent liability	341}	)	7}	(1,343)
Provision for (recovery of) guarantee liability	166}	)	(382)	(3,216)
Ending balance	\$ 22,609}	\$ 25,113	\$ 22,609}	\$ 25,113
Liability as a percentage of total guarantees	1.96%	2.10%	1.96%	2.10%

## (10) Fair Value Measurement

Assets and liabilities measured at fair value on either a recurring or non-recurring basis on the condensed consolidated balance sheets at November 30, 2010 and May 31, 2010, consist of derivative instruments, foreclosed assets, collateral-dependent non-performing loans and investments in common stock.

**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 swap derivative instruments 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 estimated yield curves.

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 participate in our revolving credit agreements. All of our exchange agreements are subject to master netting agreements.

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

At November 30, 2010 and May 31, 2010, our investments in equity securities includes investments in the Federal Agricultural Mortgage Corporation Series A common stock that is recorded in the condensed consolidated balance sheets at fair value. We calculate fair value based on the quoted price on the stock exchange where the stock is traded. That stock exchange is an active market based on the volume of shares transacted. Fair values for these securities are classified as a Level 1 valuation.

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

(dollar amounts in thousands)	November 30, 2010		May 31, 2010	
	Level 1	Level 2	Level 1	Level 2
Derivative assets	\$ -}	\$ 419,535}	\$ -	\$ 373,203
Derivative liabilities	-}	555,597}	-	482,825
Investments in common stock	926}	-}	1,029	-

**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. During the three and six months ended November 30, 2010 and 2009, we measured foreclosed assets and non-performing loans at fair value as described below.

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

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

Assets measured at fair value on a non-recurring basis at November 30, 2010 and May 31, 2010 were classified as Level 3 within the fair value hierarchy. The following table provides the carrying/fair value of the related individual assets at November 30, 2010 and May 31, 2010, and the total losses for the three and six months ended November 30, 2010 and 2009:

	Level 3 Fair Value		Total losses for the three months ended		Total losses for the six months ended	
	November 30, 2010	May 31, 2010	November 30, 2010	November 30, 2009	November 30, 2010	November 30, 2009
(dollar amounts in thousands)						
Foreclosed assets, net	\$ 254,993}	\$ 42,252	\$ (1,540)	\$ -}	\$ (1,855)	\$ (1,750)
Non-performing loans, net of specific reserves (1)	35,559}	160,285	-	(2,146)	-	(1,859)

(1) Excludes non-performing loans that are not classified as impaired at November 30, 2010.

## (11) Fair Value of Financial Instruments

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

(dollar amounts in thousands)	November 30, 2010		May 31, 2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Assets:</b>				
Cash and cash equivalents	\$ 338,671}	\$ 338,671}	\$ 513,906	\$ 513,906
Restricted cash	11,717}	11,717}	15,709	15,709
Investments in equity securities	58,504}	58,504}	58,607	58,607
Loans to members, net	18,917,294}	19,712,304}	18,749,940	19,109,838
Debt service reserve funds	45,662}	45,662}	45,662	45,662
Interest rate exchange agreements	419,535}	419,535}	373,203	373,203
<b>Liabilities:</b>				
Short-term debt	4,417,722}	4,426,872}	4,606,361	4,628,410
Long-term debt	12,579,129}	14,106,899}	12,054,497	13,408,158
Guarantee liability	22,609}	25,570}	22,984	25,917
Interest rate exchange agreements	555,597}	555,597}	482,825	482,825
Subordinated deferrable debt	186,440}	186,293}	311,440	306,151
Members' subordinated certificates	1,779,685}	1,940,437}	1,810,715	1,972,393
<b>Off-balance sheet instruments:</b>				
Commitments	-}	-}	-	-

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

The estimated market values have not been updated since November 30, 2010; therefore, current estimates of fair value may differ significantly from the amounts presented. With the exception of redeeming subordinated deferrable 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. Below is a summary of significant methodologies used in estimating fair value amounts at November 30, 2010 and May 31, 2010.

**Cash and Cash Equivalents**

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

**Restricted Cash**

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

#### Investments in Equity Securities

At November 30, 2010 and May 31, 2010, our investments in equity securities included investments in the Federal Agricultural Mortgage Corporation Series A common stock and Series C preferred stock. The Series A common stock is classified as available-for-sale securities and recorded in the condensed consolidated balance sheets at fair value. We calculate fair value based on the quoted price on the stock exchange where the stock is traded. That stock exchange is an active market based on the volume of shares transacted.

The carrying value of the Federal Agricultural Mortgage Corporation Series C preferred stock held at November 30, 2010 and May 31, 2010 is equal to cost, which approximates fair value. The fair value for the Series C preferred stock is estimated at cost because we continue to enter into new transactions with the issuer on the same terms, and the stock is callable at par. The preferred stock securities do not meet the definition of marketable securities.

#### Loans to Members, Net

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

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

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

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

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

#### Debt Service Reserve Funds

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

#### Short-Term Debt

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

#### Long-Term Debt

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

#### Subordinated Deferrable Debt

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

#### Members' Subordinated Certificates

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

### Derivative Instruments

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

### Commitments

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

### Guarantees

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

### (12) Restructured/Non-Performing Loans and Contingencies

At November 30, 2010 and May 31, 2010, there was a total specific loan loss allowance balance of \$83 million and \$437 million related to impaired loans to four borrowers, totaling \$581 million and \$1,064 million, respectively. We accrued a total of \$1 million of interest income on impaired loans for the six months ended November 30, 2010 and 2009. The average recorded investment in impaired loans for the six months ended November 30, 2010 and 2009, was \$900 million and \$1,046 million, respectively.

The following loans outstanding were classified as non-performing and restructured:

(dollar amounts in thousands)	November 30, 2010	May 31, 2010
Non-performing loans	\$ 101,261 }	\$ 560,527
Restructured loans	488,794 }	508,044
Total	\$ 590,055 }	\$ 1,068,571

At November 30, 2010 and May 31, 2010, \$92 million and \$561 million, respectively, of loans classified as non-performing were on non-accrual status with respect to the recognition of interest income. At November 30, 2010 and May 31, 2010, \$448 million and \$462 million, respectively, of restructured loans to Denton County Electric Cooperative, d/b/a CoServ Electric were on non-accrual status with respect to the recognition of interest income. Approximately \$1 million of interest income was accrued on restructured loans for the three and six months ended November 30, 2010. For the three and six months ended November 30, 2009, approximately \$1 million and \$2 million of interest income was accrued on restructured loans, respectively.

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



	For the three months ended November 30,		For the six months ended November 30,	
(dollar amounts in thousands)	2010	2009	2010	2009
Non-performing loans	\$ 319}	\$ 7,264	\$ 8,224}	\$ 14,673
Restructured loans	5,596}	5,951	11,281}	11,991
Total	\$ 5,915}	\$ 13,215	\$ 19,505}	\$ 26,664

At November 30, 2010 and May 31, 2010, non-performing loans included \$66 million and \$536 million, respectively, to ICC. On October 6, 2010, CFC took control of the USVI operating entities of ICC. The prior loan balance of \$538 million was increased by \$14 million to satisfy payment requirements under an inter-creditor agreement and transaction fees and reduced by \$30 million for the redemption of preferred stock, \$128 million fair value of the entities transferred and a charge-off of \$328 million. See further discussion in Note 3, Foreclosed Assets.

ICC's British Virgin Islands and St. Maarten entities, which represent collateral for the \$66 million of loans currently outstanding to ICC, remain subject to pending transfer. Notwithstanding the completion of the transfer of control, Jeffrey Prosser and related parties continue to assert claims against CFC and certain of its officers and directors and other parties in various proceedings and forums. CFC, therefore, anticipates that it will continue to be engaged in defense of those assertions on many fronts, as well as pursuing claims of its own. Based on our analysis, we believe we have an adequate loan loss allowance for our exposure to ICC at November 30, 2010.

At November 30, 2010 and May 31, 2010, non-performing loans also include \$26 million and \$25 million, respectively, of non-performing loans to Naknek Electric Association, a distribution electric cooperative located in Naknek, Alaska, that filed for bankruptcy in September 2010. Based on our analysis, we believe we have an adequate loan loss allowance for our exposure to Naknek at November 30, 2010.

The remaining \$9 million of non-performing loans at November 30, 2010 were outstanding to a telecommunications borrower that provides local telephone services. This borrower is more than 90 days past due on debt service payments and the situation is still in the process of being resolved.

### (13) Segment Information

The following tables contain condensed consolidated statements of operations for the six months ended November 30, 2010 and 2009 and condensed consolidated balance sheets at November 30, 2010 and 2009 by segment.

(dollar amounts in thousands)	For the six months ended November 30, 2010			
	CFC	RTFC	NCSC	Consolidated
<b>Statement of Operations:</b>				
Interest income	\$ 459,963}	\$ 28,394}	\$ 13,214}	\$ 501,571}
Interest expense	(399,916)	(26,418)	(5,579)	(431,913)
Net interest income	60,047}	1,976}	7,635}	69,658}
Recovery of loan losses	39,510}	-}	31}	39,541}
Net interest income after recovery of loan losses	99,557}	1,976}	7,666}	109,199}
<b>Non-interest income:</b>				
Fee and other income	14,425}	62}	649}	15,136}
Derivative losses	(23,377)	-}	(7,566)	(30,943)
Results of operations from foreclosed assets	(1,469)	-}	-}	(1,469)
Total non-interest income	(10,421)	62}	(6,917)	(17,276)
<b>Non-interest expense:</b>				
General and administrative expenses	(33,617)	(2,649)	(2,308)	(38,574)
Recovery of guarantee liability	382}	-}	-}	382}
Market adjustment on foreclosed assets	(1,855)	-}	-}	(1,855)
	(3,928)	-}	-}	(3,928)

Loss on early extinguishment of debt				
Other	133}	-}	(360)	(227)
Total non-interest				(44,202)
expense	(38,885)	(2,649)	(2,668)	
Income (loss) prior to income taxes	50,251}	(611)	(1,919)	47,721}
Income tax (expense) benefit	-}	(122)	728}	606}
Net income (loss)	\$ 50,251}	\$ (733)	\$ (1,191)	\$ 48,327}
Assets:				
Total loans outstanding	\$ 17,688,770}	\$ 955,411}	\$ 493,028}	\$ 19,137,209}
Deferred origination costs	5,631}	-}	-}	5,631}
Less: Allowance for loan losses	(225,543)	-}	(3)	(225,546)
Loans to members, net	17,468,858}	955,411}	493,025}	18,917,294}
Other assets	1,241,688}	169,676}	52,826}	1,464,190}
Total assets	\$ 18,710,546}	\$ 1,125,087}	\$ 545,851}	\$ 20,381,484}

(dollar amounts in thousands)	For the six months ended November 30, 2009			
	CFC	RTFC	NCSC	Consolidated
<b>Statement of Operations:</b>				
Interest income	\$ 484,576	\$ 36,790	\$ 13,010	\$ 534,376
Interest expense	(428,944)	(34,348)	(6,314)	(469,606)
Net interest income	55,632	2,442	6,696	64,770
Recovery of loan losses	14,556	-	38	14,594
Net interest income after recovery of loan losses	70,188	2,442	6,734	79,364
<b>Non-interest income:</b>				
Fee and other income	7,095	77	668	7,840
Derivative losses	(10,690)	-	(6,782)	(17,472)
Results of operations from foreclosed assets	608	-	-	608
Total non-interest income	(2,987)	77	(6,114)	(9,024)
<b>Non-interest expense:</b>				
General and administrative expenses	(28,227)	(3,011)	(2,204)	(33,442)
Recovery of guarantee liability	3,216	-	-	3,216
Market adjustment of foreclosed assets	(1,750)	-	-	(1,750)
Other	(211)	-	(110)	(321)
Total non-interest expense	(26,972)	(3,011)	(2,314)	(32,297)
Income (loss) prior to income taxes	40,229	(492)	(1,694)	38,043
Income tax (expense) benefit	-	(8)	817	809
Net income (loss)	\$ 40,229	\$ (500)	\$ (877)	\$ 38,852
<b>Assets:</b>				
Total loans outstanding	\$ 17,650,233	\$ 1,717,962	\$ 361,099	\$ 19,729,294
Deferred origination costs	3,608	-	-	3,608
Less: Allowance for loan losses	(608,402)	-	(56)	(608,458)
Loans to members, net	17,045,439	1,717,962	361,043	19,124,444
Other assets	1,090,841	178,297	44,344	1,313,482
Total assets	\$ 18,136,280	\$ 1,896,259	\$ 405,387	\$ 20,437,926

The following tables contain the condensed consolidated statements of operations for the three months ended November 30, 2010 and 2009 by segment.

(dollar amounts in thousands)	For the three months ended November 30, 2010			
	CFC	RTFC	NCSC	Consolidated
Statement of operations:				
Interest income	\$ 229,560}	\$ 13,985}	\$ 6,973}	\$ 250,518}
Interest expense	(196,564)	(12,991)	(2,846)	(212,401)
Net interest income	32,996}	994}	4,127}	38,117}
Recovery of loan losses	27,242}	-}	11}	27,253}
Net interest income after recovery of loan losses	60,238}	994}	4,138}	65,370}
Non-interest income:				
Fee and other income	4,537}	-}	307}	4,844}
Derivative gains	44,543}	-}	2,768}	47,311}
Results of operations of foreclosed assets	(1,653)	-}	-}	(1,653)
Total non-interest income	47,427}	-}	3,075}	50,502}
Non-interest expense:				
General and administrative expenses	(14,752)	(1,321)	(1,188)	(17,261)
Provision for guarantee liability	(166)	-}	-}	(166)
Market adjustment of foreclosed assets	(1,540)	-}	-}	(1,540)
Loss on early extinguishment of debt	(3,928)	-}	-}	(3,928)
Other	168}	-}	(299)	(131)
Total non-interest expense	(20,218)	(1,321)	(1,487)	(23,026)
Income (loss) prior to income taxes	87,447}	(327)	5,726}	92,846}
Income tax expense	-}	-}	(2,174)	(2,174)
Net income (loss)	\$ 87,447}	\$ (327)	\$ 3,552}	\$ 90,672}

(dollar amounts in thousands)	For the three months ended November 30, 2009			
	CFC	RTFC	NCSC	Consolidated
Statement of operations:				
Interest income	\$ 240,183	\$ 18,336	\$ 6,400	\$ 264,919
Interest expense	(206,990)	(17,046)	(2,941)	(226,977)
Net interest income	33,193	1,290	3,459	37,942
(Provision for) recovery of loan losses	(1,586)	-	9	(1,577)
	31,607	1,290	3,468	36,365

Net interest income after (provision for)  
recovery of loan losses

Non-interest income:

Fee and other income	3,738	37	331	4,106
Derivative gain (losses)	1,803	-	(4,947)	(3,144)
Results of operations of foreclosed assets	21	-	-	21
Total non-interest income	5,562	37	(4,616)	983

Non-interest expense:

General and administrative expenses	(13,888)	)	)	)
Recovery of guarantee liability	821	-	-	821
Other	(115)	-	(60)	(175)
Total non-interest expense	(13,182)	(1,497)	(1,091)	(15,770)

Income (loss) prior to income

taxes	23,987	(170)	(2,239)	21,578
Income tax (expense) benefit	-	(9)	850	841
Net income (loss)	\$ 23,987	\$ (179)	\$ (1,389)	\$ 22,419

(14) Subsequent Events

In January 2011, we entered into a \$1,500 million revolving note purchase agreement with the Federal Agricultural Mortgage Corporation. Under the terms of this note purchase agreement, we can borrow up to the committed amount at any time during the draw period, which is initially five years from the closing date and thereafter automatically extended 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. 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. No amounts have been advanced under the \$1,500 million commitment through the filing date of this report. 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. 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.

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

The following discussion and analysis is designed to provide a better understanding of our 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-Q, in addition to Part I, Item 1A. Risk Factors in our Form 10-K for the year ended May 31, 2010.

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

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

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 TIER and adjusted debt-to-equity ratio. The most closely related GAAP measures are TIER and debt-to-equity ratio. For the six months ended November 30, 2010 and 2009, the TIER was 1.11 and 1.08, respectively. At November 30, 2010, our debt-to-equity ratio was 33.94-to-1 compared to 33.33-to-1 at May 31, 2010. 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 to the related GAAP measures are to adjust interest expense to include derivative cash settlements; to adjust net income, senior debt and total equity to exclude the non-cash adjustments from the accounting for derivative financial instruments; to exclude from senior debt the amount that funds loans guaranteed by the Rural Utilities Service ("RUS"), subordinated deferrable debt and members' subordinated certificates; and to adjust total equity to include subordinated deferrable debt and members' subordinated certificates. See Non-GAAP Financial Measures for further explanation of the adjustments we make to our financial results for our own analysis and covenant compliance and for a reconciliation to the related GAAP measures.



## Executive Summary

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

## Lending Activity

The balance of loans outstanding decreased by \$201 million during the six months ended November 30, 2010 largely due to the \$472 million reduction in non-performing loans to Innovative Communication Corporation (“ICC”) as described below,

the prepayment of \$204 million of telecommunications loans related to the acquisition of one of our borrowers by a non-member and the repayment of \$212 million of power supply bridge loans with RUS funding. These bridge loans were advanced with the expectation that they would be repaid once RUS funds were advanced. The decreases in the loan balance due to the items above, as well as scheduled loan amortization, were mostly offset by \$1 billion of loan advances to CFC and NCSC borrowers to refinance their debt borrowed from other lenders during the six months ended November 30, 2010.

#### ICC Loan Bankruptcy Settlement

On October 6, 2010, CFC took control of the United States Virgin Islands (“USVI”) operating entities of ICC as partial satisfaction of RTFC loans to ICC resulting from the transfer of ICC’s assets in bankruptcy. The entities transferred had a fair value of \$128 million at that date. Due to the transfer of control, the prior loan balance of \$538 million was increased by \$14 million to satisfy payment requirements under an inter-creditor agreement and transaction fees and reduced by \$30 million for the redemption of preferred stock, \$128 million fair value of the entities transferred and a charge-off of \$328 million. In addition, CFC recorded an investment of \$216 million to foreclosed assets including the \$128 million fair value of the entities transferred and an additional investment of \$88 million to these entities to pay down or settle third-party obligations. See further discussion in Note 3, Foreclosed Assets to the condensed consolidated financial statements.

#### Funding Activity

Due to loan prepayments that occurred at the beginning of fiscal year 2011, there was initially little need for the issuance of debt during the first quarter. Our funding requirements increased during the three months ended November 30, 2010 with the maturity of collateral trust bonds totaling \$500 million, the redemption of \$125 million of 6.75 percent subordinated deferrable debt and the increased loan advance activity to members seeking to refinance their borrowings from other lenders. A higher utilization of our commercial paper issuance capacity is a key factor in our efforts to reduce our overall effective rate of borrowing as commercial paper is our lowest-cost source of debt funding. During the three months ended November 30, 2010, our average balance of commercial paper, bid notes and daily liquidity fund outstanding increased to \$3,158 million, or 93 percent of our issuance capacity provided by our revolving credit agreements, compared with \$2,074 million for the three months ended August 31, 2010 and \$2,231 million for the quarter ended November 30, 2009.

In November 2010, we issued collateral trust bonds totaling \$650 million, including \$300 million of three-year fixed-rate bonds at 1.125 percent and \$350 million of five-year fixed-rate bonds at 1.900 percent. Additionally, we issued short-term debt totaling \$400 million to the Federal Agricultural Mortgage Corporation during the three months ended November 30, 2010 at rates ranging from 0.62 percent to 0.67 percent.

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 Rural Economic Development Loan and Grant program. Under this facility, we are able to borrow funds up to the committed amount at rates ranging from 52.5 to 65 basis points over comparable maturity Treasury Bonds anytime before October 15, 2013, with each advance having a final maturity not longer than 20 years from the advance date.

#### Financial Results

We experienced an increase of \$14 million, or 28 percent, to adjusted net interest income for the six months ended November 30, 2010 compared to the prior-year period. This increase was driven primarily by a decrease to interest expense that was greater than the decrease to interest income and a \$9 million reduction to cash settlements expense. One of the factors for the decrease in interest expense during the six months ended November 30, 2010 compared to the prior-year period was the increased utilization of commercial paper in our overall funding mix at an average cost of 0.31 percent. We also incurred additional interest expense during the prior-year six-month period due to prefunding large debt maturities as we maintained commercial paper issuance capacity in reserve to address liquidity concerns in

the market at that time.

The decrease to cash settlements expense during the three and six months ended November 30, 2010 was largely due to the increase in variable interest rates. At November 30, 2010, we received a variable interest rate payment on 52 percent of our interest rates swaps, a slight increase from 51 percent at November 30, 2009. The increase in the variable interest rates for the three and six months ended November 30, 2010 compared to the prior-year periods results in an increase to the amount we received on 52 percent of our interest rate swaps and therefore a reduction to the net total we paid on our interest rate swaps as compared to the prior-year periods. There was also an increase to fee income during the six months ended

November 30, 2010 of \$6 million related to the prepayment of loans to a telecommunications borrower which was partially offset by cash settlements expense of \$3 million representing the fee we paid to terminate interest rate swaps used in the funding of such loans. Excluding the \$3 million termination fee recorded as cash settlements expense, adjusted net interest income increased \$17 million during the six months ended November 30, 2010 over the prior-year period.

For the six months ended November 30, 2010, we recorded a recovery of loan losses totaling \$40 million, an increase of \$25 million over the recovery in the prior-year period. The recovery for the six months ended November 30, 2010 was primarily the result of the reduction to reserves held for impaired loans due to increases in the fair value of the collateral supporting impaired loans and to principal repayments on impaired loans. There was a reduction to impaired loan reserves of \$15 million due to an increase in the fair value of the collateral securing impaired loans and there was a recovery of \$11 million due to principal repayments on impaired loans. In addition, there was a total decrease of \$13 million to the general reserve and the unallocated reserve associated with large loan exposures during the six months ended November 30, 2010.

The change in the items described above resulted in adjusted net income of \$74 million for the six months ended November 30, 2010 compared with \$42 million for the same prior-year period.

Our adjusted debt-to-equity ratio increased to 6.31-to-1 at November 30, 2010 as compared to 5.93-to-1 at May 31, 2010. This increase was caused by the board-authorized patronage capital retirement of \$51 million and the redemption of \$125 million of subordinated deferrable debt during the six months ended November 30, 2010, partly offset by adjusted net income of \$74 million.

#### Expectations for the Remainder of Fiscal Year 2011

We expect the demand for loan advances to repay member borrowings from other lenders to subside through the remainder of fiscal year 2011. During the period June 1, 2010 through January 1, 2011, a total of \$1,437 million of long-term fixed-rate loans were scheduled to reprice. Of that total, \$1,123 million was repriced at a new long-term fixed rate, \$249 million were repriced at a long-term variable rate, \$15 million selected a new rate offered by Federal Agricultural Mortgage Corporation and were sold by CFC to Federal Agricultural Mortgage Corporation with CFC continuing to service the loans sold and \$50 million were prepaid in full. Approximately \$300 million of long-term fixed-rate loans are scheduled to reprice from February 1, 2011 through the remainder of fiscal year 2011.

Denton County Electric Cooperative, d/b/a CoServ Electric (“CoServ”) is required to make quarterly payments to us totaling \$28 million each year as part of their restructured loan agreement. Currently, the application of the \$28 million of payments to reduce the principal balance over the next 12 months results in a reduction of \$19 million to the calculated impairment, and therefore a recovery of loan losses. In addition, CoServ’s effective rate utilized to calculate impairment on the loans outstanding from us has a variable-rate component. Based on CoServ’s current loan balance at November 30, 2010, an increase or decrease of 25 basis points to our short-term and long-term variable interest rates results in an increase or decrease of approximately \$9 million, respectively, to the calculated impairment on loans irrespective of a change in the credit fundamentals for CoServ.

We have \$750 million of debt scheduled to reprice in January 2011 for which the new interest rate will be based on a spread over the applicable treasury rate for the maturity term selected. The spread will vary between 52.5 basis points and 65 basis points depending on the maturity term selected. In December 2010, we entered into treasury lock contracts for \$125 million based on the five-year treasury rate and \$125 million based on the seven-year treasury rate with both contracts settling on January 18, 2011, the repricing date for our \$750 million of debt. As a result, we have locked in an effective rate of 2.69 percent on \$250 million of the \$750 million repricing on January 18, 2011 compared to the current effective rate of 5.32 percent resulting in annual savings of \$7 million. The interest rate on the remaining \$500 million will be set based on the applicable treasury rate and spread for the maturity term we select on January 18, 2011. In addition, we expect the refinancing of maturing collateral trust bonds and redemption of subordinated deferrable debt with new collateral trust bonds at an average interest rate of 1.54 percent described above will result in annual savings of \$20 million. Based on the combined savings of \$27 million noted above, we expect to lower our overall effective rate of borrowing over the remainder of fiscal year 2011. We also have the opportunity to lock in additional savings when we refinance \$710 million of member and retail medium-term notes maturing through May 31, 2011.

During the three months ended November 30, 2010, we elected to re-enter the retail notes market. We had not needed to obtain additional market funding through the issuance of retail notes since November 2009 when the outstanding balance had reached \$1,093 million. We plan to use this as a supplemental source of funding through the remainder of fiscal year 2011. Based on past history, as well as recent retail notes issuances totaling \$31 million in October and November 2010, we believe such market funding is available to us. The total balance of retail notes outstanding was \$823 million at November 30, 2010, with \$543 million of retail notes maturing over the next 12 months.

At November 30, 2010, we had \$3,386 million in available lines of credit under unsecured syndicated credit facilities. We expect to renew our \$967 million five-year revolving credit agreement maturing in March 2011 at approximately the current level due to improved liquidity and demand for credit from the bank loan market. As a result, we believe we will maintain our current level of commercial paper issuance capacity.

In January 2011, we entered into a \$1,500 million revolving note purchase agreement with the Federal Agricultural Mortgage Corporation. Under the terms of this note purchase agreement we can borrow up to the committed amount at any time during the draw period, which is initially five years from the closing date and thereafter automatically extended 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. 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. No amounts have been advanced under the \$1,500 million commitment through the filing date of this report.

We believe that we have sufficient liquidity from the combination of capital markets issuance, member debt issuance and private placement of debt to the Federal Agricultural Mortgage Corporation and the Federal Financing Bank, as part of the funding mechanism for the Rural Economic Development Loan and Grant program, to satisfy our need for additional funding. At November 30, 2010, we were in compliance with all covenants and conditions under our revolving credit agreements and debt indentures.

#### New Accounting Pronouncements

During the six months ended November 30, 2010, we did not change or adopt any new accounting policies that had a material effect on our consolidated financial condition or results of operations.

#### Results of Operations

The derivative cash settlements and derivative forward value line items for the three and six months ended November 30, 2009 were combined and reported as derivative gains (losses) in the non-interest income section of the condensed consolidated statement of operations to conform to the November 30, 2010 presentation.

#### Three and six months ended November 30, 2010 versus November 30, 2009 results of operations

	For the three months ended November 30,			For the six months ended November 30,		
(dollar amounts in thousands)	2010	2009	Change	2010	2009	Change
Interest income	\$ 250,518}	\$ 264,919	\$(14,401)	\$ 501,571}	\$ 534,376	\$(32,805)
Interest expense	(212,401)	(226,977)	14,576}	(431,913)	(469,606)	37,693}
Net interest income	38,117}	37,942	175}	69,658}	64,770	4,888}
Recovery of (provision for) loan losses	27,253}	(1,577)	28,830}	39,541}	14,594	24,947}
Net interest income after recovery of (provision for) loan losses	65,370}	36,365	29,005}	109,199}	79,364	29,835}
Non-interest income:						
Fee and other income	4,844}	4,106	738}	15,136}	7,840	7,296}
Derivative gains (losses)	47,311}	(3,144)	50,455}	(30,943)	(17,472)	(13,471)
Results of operations from foreclosed assets	(1,653)	21	(1,674)	(1,469)	608	(2,077)
Total non-interest income	50,502}	983	49,519}	(17,276)	(9,024)	(8,252)

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Non-interest expense:						
Salaries and employee benefits	(9,694)	(9,766)	72}	(22,720)	(19,684)	(3,036)
Other general and administrative expenses	(7,567)	(6,650)			(13,758)	
(Provision for) recovery of guarantee liability			(917)	(15,854)		(2,096)
Market adjustment on foreclosed assets	(166)	821	(987)	382}	3,216	(2,834)
Loss on early extinguishment of debt	(1,540)	-	(1,540)	(1,855)	(1,750)	(105)
Other	(3,928)	-	(3,928)	(3,928)	-	(3,928)
Total non-interest expense	(131)	(175)	44}	(227)	(321)	94}
	(23,026)	(15,770)	(7,256)	(44,202)	(32,297)	(11,905)
Income prior to income taxes	92,846}	21,578	71,268}	47,721}	38,043	9,678}
Income tax (expense) benefit	(2,174)	841	(3,015)	606}	809	(203)
Net income	90,672}	22,419	68,253}	48,327}	38,852	9,475}
Less: Net (income) loss attributable to noncontrolling interest	(3,225)	1,568	(4,793)	1,924}	1,377	547}
Net income attributable to CFC	\$ 87,447}	\$ 23,987	\$ 63,460}	\$ 50,251}	\$ 40,229	\$ 10,022}
TIER	1.43}	1.10		1.11}	1.08	
Adjusted TIER (1)	1.20}	1.06		1.17}	1.09	

(1) Adjusted to exclude the effect of the derivative forward value from net income and to include all derivative cash settlements in the interest expense. See Non-GAAP Financial Measures for further explanation and a reconciliation of these adjustments.

#### Interest Income

The following tables break out the average yield 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

	For the three months ended November 30,					
	2010	2009	2010	2009	2010	2009
(dollar amounts in thousands)	Average volume		Interest income		Average yield	
Long-term fixed-rate loans (1)	\$ 16,217,452}	\$ 15,476,573}	\$ 226,397}	\$ 225,550}	5.60%	% 5.85
Long-term variable-rate loans (1)	1,347,331}	2,295,925}	11,345}	21,686}	3.38	3.79
Short-term loans (1)	1,385,687}	1,713,386}	10,346}	14,641}	2.99	3.43
Non-performing loans	277,851}	523,795}	-}	-}	-}	-}
Total loans	19,228,321}	20,009,679}	248,088}	261,877}	5.18	5.25
Investments (2)	518,951}	287,051}	1,004}	1,329}	0.78	1.86
Fee income	-}	-}	1,426}	1,713}	-}	-}
Total	\$ 19,747,272}	\$ 20,296,730}	\$ 250,518}	\$ 264,919}	5.09	5.24

#### Average balances and interest rates - Assets

	For the six months ended November 30,					
	2010	2009	2010	2009	2010	2009
(dollar amounts in thousands)	Average volume		Interest income		Average yield	
Long-term fixed-rate loans (1)	\$ 15,924,097}	\$ 15,325,993}	\$ 449,366}	\$ 449,076}	5.63%	% 5.84
Long-term variable-rate loans (1)	1,401,608}	2,458,061}	24,001}	48,251}	3.42	3.92
Short-term loans (1)	1,462,221}	1,806,136}	22,323}	30,676}	3.04	3.39
Non-performing loans	420,311}	523,777}	-}	-}	-}	-}
Total loans	19,208,237}	20,113,967}	495,690}	528,003}	5.15	5.24
Investments (2)	392,563}	637,631}	2,034}	2,986}	1.03	0.93
Fee income	-}	-}	3,847}	3,387}	-}	-}
Total	\$ 19,600,800}	\$ 20,751,598}	\$ 501,571}	\$ 534,376}	5.10	5.14

(1) Interest income on loans to members.

(2) Interest income on the investment of excess cash and equity securities.

#### Analysis of changes in interest income

For the three months ended  
November 30, 2010 vs. 2009  
Change due to (3)

For the six months ended  
November 30, 2010 vs. 2009  
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):						
Long-term fixed-rate loans	\$ 10,797}	\$ (9,950)	\$ 847}	\$ 17,525}	\$ (17,235)	\$ 290}
Long-term variable-rate loans	(8,960)	(1,381)	(10,341)	(20,738)	(3,512)	(24,250)
Short-term loans	(2,800)	(1,495)	(4,295)	(5,841)	(2,512)	(8,353)
Total interest income on loans	(963)	(12,826)	(13,789)	(9,054)	(23,259)	(32,313)
Investments	1,074}	(1,399)	(325)	(1,148)	196}	(952)
Fee income	-}	(287)	(287)	-}	460}	460}
Total interest income	\$ 111}	\$ (14,512)	\$ (14,401)	\$ (10,202)	\$ (22,603)	\$ (32,805)

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

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

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

During the three and six months ended November 30, 2010, interest income decreased 5 percent and 6 percent, respectively, compared to the prior-year period due to the 4 percent and 5 percent decrease in average loan volume and the 7 basis point and 9 basis point decrease in the average yield on loans, respectively. The average loan balance for the three and six months ended November 30, 2010 decreased compared to the prior-year period largely due to \$504 million of repayments from power supply bridge loans with loan funds from RUS and the sale of \$297 million of distribution and power supply loans to the Federal Agricultural Mortgage Corporation, a total of \$130 million of which were advanced at the time of sale, both of

which occurred since November 30, 2009. In addition, the average loan balance during the six months ended November 30, 2010 decreased \$204 million compared with the prior-year period due to the prepayment of telecommunications loans as a result of the acquisition of one of our borrowers by a non-member in June 2010 and \$472 million due to the transfer of control of ICC's USVI entities to CFC in October 2010. ICC's loans were non-performing and on non-accrual status; therefore, there was no impact on interest income as a result of the decrease to these loans.

The decrease in the average yield is influenced by the overall decline of the interest rates on new fixed-rate loans, and competitive pressure. As a cost-based lender, we extend new loans with fixed rates based on our cost of debt at the time of the advance. The financial crisis beginning in September 2008 increased our cost of issuing new debt and, therefore, long-term fixed rates were higher during the three and six months ended November 30, 2009. Since that time, corporate spreads tightened, thus allowing us to lower long-term fixed rates we offer on our new loans. The average long-term fixed rate interest rates we offered on electric loans for the three and six months ended November 30, 2010 decreased 100 basis points and 88 basis points, respectively, compared to the prior-year period.

The effect of changes to interest rates in the capital markets on our interest income was limited to a certain extent since 83 percent and 76 percent of our average loan balance was for long-term fixed-rate loans during the six months ended November 30, 2010 and 2009, respectively. Loans converting from a variable rate to a fixed rate since November 30, 2009 totaled \$703 million, which was partially offset by loans that converted from a fixed to a variable rate totaling \$494 million.

During the six months ended November 30, 2010, the weighted average interest rate for fixed-rate loans advanced of 4.12 percent and loans repaid of 5.38 percent were lower than the average yield on total long-term fixed-rate loans in the prior-year period of 5.84 percent. Since advances outweighed repayments, resulting in a 4 percent increase in average loan volume for fixed-rate loans, there was a decrease to the yield on fixed-rate loans compared to the prior-year period.

In addition to lower rates being offered, our members selected shorter rate-terms for new fixed-rate loan advances during the six months ended November 30, 2010 compared to the prior-year period. The rate-terms with shorter duration carry lower fixed interest rates, which translates to lower average yields. The weighted-average term on fixed-rate advances was 6.6 years for the six months ended November 30, 2010, compared with 8.1 years for the prior-year period.

At November 30, 2010, approximately 54 percent of the outstanding balance of our interest-bearing line of credit loans were priced at rates lower than our standard line of credit interest rates because of loan syndications and due to competition for the line of credit loan business. Of the line of credit loans priced lower than our standard rates at November 30, 2010, 30 percent were made as part of loan syndications where the pricing was agreed upon by all of the participating banks and is based on current market conditions rather than our standard line of credit rates.

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

(dollar amounts in thousands)	For the three months ended November 30,		For the six months ended November 30,	
	2010	2009	2010	2009
Electric	\$ 5,915}	\$ 5,951	\$ 12,101}	\$ 11,991
Telecommunications	-}	7,264	7,404}	14,673

Total	\$ 5,915}	\$ 13,215	\$ 19,505}	\$ 26,664
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The decrease in interest foregone for telecommunications loans on non-accrual status was due to the court settlement of non-accrual loans to ICC. Loans remaining on non-accrual status relate primarily to restructured loans to CoServ. The decrease to interest income from holding CoServ's loans on non-accrual status is largely offset by the reduction to the calculated impairment due to CoServ's principal payments, which results in a reduction to the required loan loss provision or increases the recovery for the period. As a result, there is a limited effect on the overall financial statements from these non-accrual loans. During the six months ended November 30, 2010, CoServ made scheduled payments of \$14 million, all of which were applied as a reduction to the loan principal balance and resulted in a reduction of \$11 million to the calculated impairment.

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 borrowed by our members with specific debt. Rather, we attempt to minimize cost 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. Management calculates an adjusted interest expense, which includes all derivative cash settlements in interest expense. See Non-GAAP Financial Measures for further explanation of the adjustment we make in our financial analysis to include all derivative cash settlements in interest expense.

## Average balances and interest rates - Liabilities

For the three months ended November 30,

	2010	2009	2010	2009	2010	2009
(dollar amounts in thousands)	Average volume		Interest expense		Average cost	
Commercial paper and bank bid						
notes (1) (2)	\$ 3,158,262}	\$ 2,230,910	\$ (2,286)	\$ (1,964)	(0.29)%	(0.35)%
Medium-term notes (1)	3,977,454}	4,339,188	(61,096)	(65,902)	(6.16)	(6.09)
Collateral trust bonds (1)	4,975,172}	5,607,943	(75,247)	(81,585)	(6.07)	(5.84)
Subordinated deferrable debt (1)	180,907}	301,904	(2,830)	(4,915)	(6.27)	(6.53)
Subordinated certificates (1)	1,764,382}	1,757,277	(20,218)	(19,787)	(4.60)	(4.52)
Long-term private debt (1)	4,769,626}	4,824,387	(45,632)	(47,568)	(3.84)	(3.95)
Total debt	18,825,803}	19,061,609	(207,309)	(221,721)	(4.42)	(4.67)
Debt issuance costs (3)	-}	-	(2,541)	(2,625)	-}	-
Fee expense (4)	-}	-	(2,551)	(2,631)	-}	-
Total	\$ 18,825,803}	\$ 19,061,609	\$ (212,401)	\$ (226,977)	(4.53)	(4.78)
Derivative cash settlements (5)	\$ 11,349,821}	\$ 11,573,493	\$ (373)	\$ (10,706)	(0.01)%	(0.37)%
Adjusted interest expense (6)	18,825,803}	19,061,609	(212,774)	(237,683)	(4.53)	(5.00)

## Average balances and interest rates - Liabilities

For the six months ended November 30,

	2010	2009	2010	2009	2010	2009
(dollar amounts in thousands)	Average volume		Interest expense		Average cost	
Commercial paper and bank bid						
notes (1) (2)	\$ 2,613,217}	\$ 2,350,929	\$ (4,009)	\$ (5,186)	(0.31)%	(0.44)%
Medium-term notes (1)	4,080,510}	4,987,385	(124,200)	(150,497)	(6.07)	(6.02)
	5,102,748}	5,393,709	(153,796)	(160,178)	(6.01)	(5.92)

Collateral trust bonds (1)						
Subordinated deferrable debt (1)	241,765}		301,895	(7,746)	(9,831)	(6.39)
Subordinated certificates (1)	1,760,966}		1,728,401	(40,524)	(38,807)	(4.59)
Long-term private debt (1)	4,651,405}		4,645,023	(91,624)	(93,554)	(3.93)
Total debt	18,450,611}	\$ 19,407,342	(421,899)	(458,053)	(4.56)	(4.71)
Debt issuance costs (3)	-}	-	(5,118)	(5,605)	-}	-
Fee expense (4)	-}	-	(4,896)	(5,948)	-}	-
Total	\$ 18,450,611}	\$ 19,407,342	\$ (431,913)	\$ (469,606)	(4.67)	(4.83)
Derivative cash settlements (5)	\$ 11,251,958}	\$ 11,665,572	\$ (4,835)	\$ (14,200)	(0.09)%	(0.24)%
Adjusted interest expense (6)	18,450,611}	19,407,342	(436,748)	(483,806)	(4.72)	(4.97)

(1) Interest expense includes the amortization of discounts on debt.

(2) Average volume includes the daily liquidity fund.

(3) Interest expense includes amortization of all deferred charges related to debt issuances, principally underwriter's fees, legal fees, printing costs and comfort letter fees. Amortization is calculated on the effective interest method. Also includes issuance costs related to dealer commercial paper, which are recognized as incurred.

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

(5) For derivative cash settlements, average volume represents the average notional amount of derivative contracts outstanding, and the average cost represents the net difference between the average rate paid and the average rate received for cash settlements during the period.

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

## Analysis of changes in interest expense

(dollar amounts in thousands) (Increase) decrease:	For the three months ended November 30, 2010 vs. 2009 Change due to (3)			For the six months ended November 30, 2010 vs. 2009 Change due to (3)		
	Average volume (1)	Average rate (2)	Net change	Average volume (1)	Average rate (2)	Net change
Commercial paper and bank bid notes	(816)	494}	(322)	(579)	1,756}	1,177}
Medium-term notes	5,494}	(688)	4,806}	27,365}	(1,068)	26,297}
Collateral trust bonds	9,206}	(2,868)	6,338}	8,641}	(2,259)	6,382}
Subordinated deferrable debt	1,970}	115}	2,085}	1,958}	127}	2,085}
Subordinated certificates	(80)	(351)	(431)	(731)	(986)	(1,717)
Long-term private debt	540}	1,396}	1,936}	(129)	2,059}	1,930}
Total interest expense on debt	16,314}	(1,902)	14,412}	36,525}	(371)	36,154}
Debt issuance costs	-}	84}	84}	-}	487}	487}
Fee expense	-}	80}	80}	-}	1,052}	1,052}
Total interest expense	\$ 16,314}	\$ (1,738)	\$ 14,576}	\$ 36,525}	\$ 1,168}	\$ 37,693}
Derivative cash settlements (4)	\$ 207}	\$ 10,126}	\$ 10,333}	\$ 503}	\$ 8,862}	\$ 9,365}
Adjusted interest expense (5)	2,940}	21,969}	24,909}	23,850}	23,208}	47,058}

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

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

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

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

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

During the three months ended November 30, 2010, interest expense decreased 6 percent compared with the same prior-year period primarily due to the 25 basis point reduction in the total cost of debt. The largest factor contributing to this decrease was our refinancing of maturing debt with commercial paper based on our available issuance capacity, resulting in an increased utilization of commercial paper in our overall funding mix. At an average cost of 0.29 percent for the three months ended November 30, 2010, commercial paper is our lowest-cost source of debt funding and represented 17 percent of the total average debt outstanding compared with 12 percent for the prior-year period.

During the six months ended November 30, 2010, interest expense decreased 8 percent compared to the same prior-year period primarily due to the 16 basis point reduction to the total cost of debt and the 5 percent decrease in the average balance of debt outstanding. The lower cost of debt was the result of increasing commercial paper in our overall funding mix during the second quarter of fiscal year 2011 as noted above. The decrease in the average debt

outstanding was due to the 5 percent decrease in the average loan balance during the six months ended November 30, 2010 and a higher average debt balance in the prior-year period due to prefunding large debt maturities. We prefunded large debt maturities during the three months ended November 30, 2009 as part of an initiative to maintain commercial paper issuance capacity in reserve in order to minimize liquidity risk due to market conditions at that time.

The adjusted interest expense, which includes all derivative cash settlements, was \$213 million and \$437 million for the three and six months ended November 30, 2010, respectively, compared to \$238 million and \$484 million for the three and six months ended November 30, 2009. The adjusted interest expense was lower during the three and six months ended November 30, 2010 due to the lower interest expense noted above partially offset by the decrease in the derivative cash settlements expense discussed further below. See Non-GAAP Financial Measures for further explanation of the adjustment we make in our financial analysis to include all derivative cash settlements in interest expense.

## Net Interest Income

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

## Average interest rates – Assets and Liabilities

	For the three months ended November 30,			
	2010	2009	2010	2009
(dollar amounts in thousands)	Interest income (expense)		Average yield (cost)	
Total interest income	\$ 250,518}	\$ 264,919	5.09%	5.24%
Total interest expense	(212,401)	(226,977)	(4.53)	(4.78)
Net interest income/Net yield (cost)	\$ 38,117}	\$ 37,942	0.56%	% 0.46
Derivative cash settlements	(373)	(10,706)	(0.01)	(0.37)
Adjusted net interest income/Adjusted net yield (1)	\$ 37,744}	\$ 27,236	0.56	0.24

## Average interest rates – Assets and Liabilities

	For the six months ended November 30,			
	2010	2009	2010	2009
(dollar amounts in thousands)	Interest income (expense)		Average yield (cost)	
Total interest income	\$ 501,571}	\$ 534,376	5.10%	5.14%
Total interest expense	(431,913)	(469,606)	(4.67)	(4.83)
Net interest income/Net yield (cost)	\$ 69,658}	\$ 64,770	0.43%	% 0.31
Derivative cash settlements	(4,835)	(14,200)	(0.09)	(0.24)
Adjusted net interest income/Adjusted net yield (1)	\$ 64,823}	\$ 50,570	0.38	0.17

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

## Analysis of changes in net interest income

	For the three months ended November 30, 2010 vs. 2009			For the six months ended November 30, 2010 vs. 2009		
	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 net interest income	\$ 16,425}	\$ (16,250)	\$ 175}	\$6,323}	(\$1,435)	\$ 4,888}



Increase (decrease) in adjusted net interest income	3,051}	7,457}	10,508}	13,648}	605}	14,253}
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(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.

The net interest income for the three months ended November 30, 2010 remained relatively flat compared with the prior-year period despite the 10 basis point increase in the average net yield. During the three months ended November 30, 2010, we were able to offset the decrease in interest income due to the \$781 million, or 4 percent, decrease in average loan volume and the 7 basis point decrease in the average yield of our loan portfolio with the 25 basis point decrease in the overall cost of debt.

During the six months ended November 30, 2010, the net interest income increased by \$5 million, or 8 percent, compared with the same prior-year period. This increase was due to the 16 basis point reduction in the overall cost of debt, partly offset by the 9 basis point decrease in the average yield of our loan portfolio. The \$957 million, or 5 percent, decrease in the average debt volume was offset by the \$906 million, or 5 percent, decrease in average loan volume.

The adjusted net interest income, which includes all derivative cash settlements, for the three and six months ended November 30, 2010 was \$38 million and \$65 million, respectively, an increase compared to \$27 million and \$51 million for the three and six months ended November 30, 2009. The increase in adjusted net interest income for both the three and six months ended November 30, 2010 as compared to the prior-year periods was primarily due to the reduction to cash settlements expense described further in the discussion of non-interest income, as well as the increase to net interest income as described above.

### Recovery of Loan Losses

During the three months ended November 30, 2010, there was a loan loss recovery of \$27 million compared to a provision of \$2 million for the prior-year period. The recovery of loan losses for the three months ended November 30, 2010 was primarily due to a decrease in the reserves held for impaired loans as a result of an increase in the fair value of the collateral securing such impaired loans and due to principal repayments on impaired loans. Specifically, there was a recovery of \$21 million due to an increase in the fair value of the collateral securing impaired loans and there was a recovery of \$5 million due to principal repayments on impaired loans.

The recovery of loan losses of \$40 million for the six months ended November 30, 2010 was the result of an increase in the fair value of the collateral securing impaired loans, principal repayments on impaired loans, improvements to the weighted average portfolio risk rating and a decrease to the required reserves for large exposures. There was a reduction to impaired loan reserves of \$15 million due to an increase in the fair value of the collateral securing impaired loans and there was a recovery of \$11 million due to principal repayments on impaired loans. In addition, there was a decrease of \$8 million to the general reserve due to decreases in the weighted average risk rating and weighted average maturity for the loans in the general reserve, partly offset by an increase in the total loans in the general reserve. There was also a \$5 million reduction to the unallocated reserve associated with large loan exposures due to loan repayments and improvement to the average internal risk rating during the six months ended November 30, 2010 for borrowers that meet the exposure threshold.

### Non-interest Income

Non-interest income increased by \$50 million for the three months ended November 30, 2010 compared to the prior-year period primarily due to the \$50 million increase in derivative gains. Non-interest income also includes a \$2 million net loss representing the results of operations of foreclosed assets for USVI entities transferred to CFC on October 6, 2010. Non-interest income decreased by \$8 million for the six months ended November 30, 2010 compared to the prior-year period primarily due to the \$13 million increase in derivative losses and the \$2 million net loss for USVI entities in foreclosed assets offset by the \$7 million increase in fee income.

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

(dollar amounts in thousands)	For the three months ended November 30,			For the six months ended November 30,		
	2010	2009	Net Change	2010	2009	Net Change
Derivative cash settlements	\$ (373)	\$ ) (10,706)	\$ 10,333}	\$ (4,835)		