NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORP /DC/
Form 10-K
August 19, 2011

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

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended May 31, 2011

OR

o 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)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered	Title of each class	Name of each exchange on which registered
7.20% Collateral Trust Bonds, due 2015	NYSE	6.10% Subordinated Notes, due 2044	NYSE
6.55% Collateral Trust Bonds, due 2018	NYSE	5.95% Subordinated Notes, due 2045	NYSE
	NYSE		

7.35% Collateral Trust
Bonds, due 2026

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ¨ No x

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 x 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant‘s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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 x Smaller reporting company ¨

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

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

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Form 10-K 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 sim expressions, whether in the negative or affirmative. All statements about future expectations or projections, including statements about loan volume, the adequacy of the loan loss allowance, operating income and expenses, leverage and debt-to-equity ratios, borrower financial performance, impaired loans, and sources and uses of liquidity, are forward-looking statements. Although we believe that the expectations reflected in our forward-looking statements are based on reasonable assumptions, actual results and performance could materially differ. Factors that could cause future results to vary from current expectations include, but are not limited to, general economic conditions, legislative changes, 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, initial valuations of assets received in foreclosure, 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 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.

The information in this section should be read with our consolidated financial statements and related notes and the information contained elsewhere in this Form 10-K, including that set forth under Item 1A. Risk Factors and Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

PART I

Item 1. Business.

General

National Rural Utilities Cooperative Finance Corporation (“CFC”) is a member-owned cooperative association incorporated under the laws of the District of Columbia in April 1969. CFC’s principal purpose is to provide its members with financing to supplement the loan programs of the Rural Utilities Service (“RUS”) of the United States Department of Agriculture. CFC makes loans to its rural electric members so they can acquire, construct and operate electric distribution, generation, transmission and related facilities. CFC also provides its members with credit enhancements in the form of letters of credit and guarantees of debt obligations. As a cooperative, CFC is owned by and exclusively serves its membership, which consists solely of not-for-profit entities or subsidiaries or affiliates of not-for-profit entities. CFC is exempt from federal income taxes under Section 501(c)(4) of the Internal Revenue Code. As a member-owned cooperative, CFC has no publicly held equity securities outstanding. CFC funds its activities primarily through a combination of publicly and privately held debt securities and member investments. CFC’s objective is to offer its members cost-based financial products and services consistent with sound financial management and is not to maximize net income. As described under Allocation and Retirement of Patronage Capital on page 24, CFC allocates its net earnings, which consist of net income excluding the effect of certain non-cash accounting entries, annually to a cooperative educational fund, a members’ capital reserve and to members based on each member’s patronage of CFC’s loan programs during the year.

For financial statement purposes, CFC's results of operations and financial condition are consolidated with and include Rural Telephone Finance Cooperative ("RTFC") and National Cooperative Services Corporation ("NCSC"). Unless stated otherwise, references to "we," "our" or "us" relate to the consolidation of CFC, RTFC, NCSC and certain entities created and controlled by CFC to hold foreclosed assets and to accommodate loan securitization transactions. The revenue, net profit or loss and total assets of CFC are presented as a reportable segment in Note 15, Segment Information, to the consolidated financial statements.

Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports are available, free of charge, at www.nrucfc.coop (under the link "Investor Relations/Financial Reporting") as soon as reasonably practicable after they are electronically filed with or furnished to the SEC. These reports are also available free of charge on the SEC website at www.sec.gov. Information posted on our website is not incorporated by reference into this Form 10-K.

RTFC is a cooperative association originally incorporated in South Dakota in 1987 and reincorporated as a member-owned cooperative association in the District of Columbia in 2005. RTFC's principal purpose is to provide and arrange financing for its rural telecommunications members and their affiliates. RTFC's membership consists of a combination of not-for-profit entities and for-profit entities. CFC is the sole lender to and manages the lending activities of RTFC through a long-term management agreement. Under a guarantee agreement, RTFC pays CFC a fee and, in exchange, CFC reimburses RTFC for loan losses. RTFC is headquartered with CFC in Herndon, Virginia. RTFC is a taxable cooperative that pays income tax based on its net income, excluding patronage-sourced net earnings allocated to its patrons, as permitted under Subchapter T of the Internal Revenue Code.

NCSC was incorporated in 1981 in the District of Columbia as a member-owned cooperative association. The principal purpose of NCSC is to provide financing to members of CFC, entities eligible to be members of CFC and the for-profit and non-profit entities that are owned, operated or controlled by, or provide significant benefit to Class A, B and C members of CFC. NCSC's membership consists of CFC and distribution systems that are members of CFC or are eligible for such membership. CFC is the primary source of funding to and manages the lending activities of NCSC through a management agreement that is automatically renewable on an annual basis unless terminated by either party. Under a guarantee agreement, NCSC pays CFC a fee and, in exchange, CFC reimburses NCSC for loan losses. NCSC is headquartered with CFC in Herndon, Virginia. NCSC is a taxable cooperative that, to date, has not allocated its patronage-sourced net earnings to members. Thus, NCSC pays income tax on the full amount of its net income.

Our Business Development

Our business strategy and policies are set by our Board of Directors and, in general, may be amended or revised from time to time by the Board of Directors. Over the past five years, we have undertaken the following initiatives as a result of the strategic planning of our Board of Directors: (i) focus on electric lending while strategically decreasing telecommunications exposures, (ii) obtain and diversify sources of funding to meet our capital needs, (iii) enhance market risk management and (iv) increase and retain investments by our members for longer periods.

Focus on Electric Lending

Over the past five years, we renewed our focus on lending to our electric systems while strategically decreasing our telecommunications exposure through RTFC. CFC's primary focus is lending to its core distribution and power supply members that represent 92 percent of the outstanding loan portfolio at May 31, 2011, compared with RTFC loans outstanding that represent 4 percent of the total loan portfolio. Our electric cooperative borrowers have demonstrated stable operating performance and strong financial ratios, even during the recent economic downturn, as the majority of electric cooperatives' customers are residential, for whom electricity is an essential service. Our electric cooperative members experience limited competition as they generally operate in exclusive territories, the majority of which are not rate regulated. Additionally, they have access to low-cost capital from the federal government in addition to our lending resources. In our 42-year history, we have had no net write-offs for distribution borrowers and $68 million in net write-offs for power supply borrowers. On the other hand, the telecommunications service providers, to which RTFC provides loans, have experienced fast-paced technological change, increasing competition and uncertainty with respect to their regulatory environment. For these reasons, RTFC became more selective as to the companies it finances and strategically exited or reduced its exposure to its larger borrowers. The telecommunications portfolio decreased by 60 percent over the last five years compared with a 14 percent increase to loans outstanding to CFC's electric distribution and power supply borrowers.

Obtain Diverse Funding Sources

Diversifying our funding sources to expand beyond capital markets offerings of collateral trust bonds and medium-term notes and the sale of commercial paper was a primary initiative over the past five years. To help meet our capital needs, we expanded our funding programs to include the Guaranteed Underwriter program of the U.S.

Department of Agriculture, as well as note purchase agreements and whole-loan sale programs with the Federal Agricultural Mortgage Corporation. From fiscal year 2006 to fiscal year 2011, we entered into four bond purchase agreements with the Federal Financing Bank totaling $3,500 million with a guarantee of repayment by RUS as part of the funding mechanism for the Rural Economic Development Loan and Grant program. At May 31, 2011, we had debt outstanding totaling $3,150 million under this program, with a remaining commitment of $350 million available. Currently, we have an application to RUS for an additional $500 million of RUS-guaranteed Federal Financing Bank loans authorized under this program. The guarantee fees paid to the government by CFC in connection with these borrowings are used to fund economic development programs administered by RUS in the rural areas served by electric cooperatives. Starting in fiscal year 2009, we entered into note purchase agreements with the Federal Agricultural Mortgage Corporation that totaled $2,400 million at May 31, 2009 and 2010. During fiscal year 2011, all note purchase agreements were consolidated into one agreement and the amount available increased $1,500 million. Under the agreement we may borrow, repay and re-borrow funds up to $3,900 million at any time or from time to time through January 11, 2016 as market conditions permit. We may select a fixed rate or a variable rate at the time of each advance. Additionally, we developed a program to sell member systems' distribution and power supply loans to the Federal Agricultural Mortgage Corporation to help manage single-obligor exposures within our loan portfolio, as an additional form of liquidity and to manage the level of our debt-to-equity ratio. During the fiscal years ended May 31, 2011, 2010 and 2008, we sold CFC distribution and power supply loans with outstanding principal balances totaling $327 million, $128 million and $74 million, respectively, at par to the Federal Agricultural Mortgage Corporation for cash. Prior to the end of fiscal year 2011 and soon after fiscal year end, we entered into agreements with two additional partners for the sale of our loans. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources for additional information regarding our funding sources.

Enhance Market Risk Management
In fiscal year 2011, we continued the practice of having regularly scheduled monthly Asset Liability Committee meetings to enhance the overall corporate monitoring of our funding activities. Our Asset Liability Committee was established in fiscal year 2009 and monitors our management of risks related to interest rates, counterparty credit and liquidity to ensure consistent access to funding that is in alignment with our strategic goals. The committee's mandate is to review CFC's liquidity, as well as the relationship of interest rates and tenor of our assets to our liabilities and, as a result, our spread between interest income and interest expense. Functional responsibilities of this committee include reviewing pricing and other funding decisions, investment decisions and trends in funding alternatives and risk exposure. Performance results and budget deviations also are reviewed. If necessary, the organization's asset-liability strategy is reviewed for modification to react to the current market environment. At least monthly, the Asset Liability Committee reviews a complete interest rate risk analysis, reviews proposed modifications, if any, to our interest rate risk management strategy and considers adopting strategy changes. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Market Risk for additional information regarding our market risk management.

Increase Member Investments and Equity Retention
In fiscal year 2009, we developed a corporate objective to increase the investments of our members and our equity retention by implementing two primary initiatives: (i) offering of member capital securities, a 35-year unsecured and subordinated voluntary debt investment, to our members beginning in November 2008 and (ii) adjusting CFC's patronage capital retirement practices in June 2009.

Member capital securities are unsecured obligations and are subordinate to all of our existing and future senior indebtedness and all of our existing and future subordinated indebtedness that may be held by or transferred to non-members, but rank on a parity to all other members' subordinated certificates. Since fiscal year 2009, the initial year of the program, we have issued $398 million of member capital securities at a 35-year maturity that were callable at par by CFC starting five years from the date of issuance and anytime thereafter. The majority of member capital securities were issued with a 7.5 percent interest rate. Effective January 1, 2010, the fixed interest rate earned on our member capital securities changed from 7.5 percent to 5 percent. Since that time, an insignificant amount of member capital securities have been issued. For computing compliance with our revolving credit agreement covenants, we are required to adjust our leverage ratio by subtracting members' subordinated certificates, including member capital securities, from total liabilities and adding this amount to total equity. The leverage and debt-to-equity ratios adjusted to treat members' subordinated certificates as equity rather than debt reflect management's perspective on our operations.

At the end of each fiscal year, CFC's Board of Directors allocates its net earnings to members in the form of patronage capital and to board-approved reserves. CFC bases the amount of net earnings allocated to each member on the member's patronage of CFC's lending programs during the year. CFC's Board of Directors historically votes to retire a portion of the prior year's patronage capital allocation. In June 2009, CFC revised its guidelines to retire 50 percent of its prior year's allocated net earnings and hold the remaining 50 percent for 25 years in order to further strengthen its equity position. CFC's practice prior to June 2009 was to retire 70 percent of its prior year's allocated net earnings and hold the remaining 30 percent for 15 years. For the years ended May 31, 2011, 2010 and 2009, the amount of allocated net earnings we retired was reduced by $18 million, $20 million and $17 million, respectively, as a result of the change in the retirement practices.

Our Loan Programs

CFC lends to its members and associates; RTFC lends to its members, organizations affiliated with its members and its associates; NCSC lends to its members and associates. The loans to the affiliated organizations may require a guarantee of repayment to NCSC from the CFC member cooperative with which it is affiliated.

The loans of CFC, RTFC and NCSC generally provide that an event of default has occurred if there is any material adverse change in the business condition, financial or otherwise, of the borrower. Our loan standards are generally comparable to those of RUS, and most members significantly exceed the financial tests set by both RUS and CFC.

CFC Loan Programs
Long-Term Loans
CFC's long-term loans generally have the following characteristics:

- terms of up to 35 years on a senior secured basis;
- amortizing or bullet maturity loans with serial payment structures;
- the property, plant and equipment financed by and securing the long-term loan has a useful life equal to or in excess of the loan maturity;
- flexibility for the borrower to select a fixed interest rate for periods of one to 35 years or a variable rate; and
- the ability for the borrower to select various tranches with either a fixed or variable interest rate for each tranche.

Borrowers may select a fixed or a variable interest rate at the time of each advance on long-term loan facilities. When selecting a fixed rate, the member has the option to choose a fixed rate for a term of one year through the final maturity of the loan. When the selected fixed interest rate term expires, the borrower may select another fixed rate for a term of one year through the loan maturity or the current variable rate. Electric long-term fixed rates are set daily for new loan advances and loans that reprice. The long-term variable rate is set on the first day of each month. The fixed rate on each loan is determined on the day the loan is advanced or repriced based on the term selected.

To be in compliance with the covenants in the loan agreement and eligible for loan advances, distribution systems generally must maintain an average modified debt service coverage ratio, as defined in the loan agreement, of 1.35 or greater. Similarly, power supply systems generally must maintain an average modified debt service coverage ratio, as defined in the loan agreement, of 1.0 or greater. CFC may make long-term loans to distribution and power supply systems, on a case-by-case basis, that do not meet these general criteria.

Line of credit loans
Line of credit loans are generally unsecured. Line of credit loans are designed primarily to assist borrowers with liquidity and cash management and are generally advanced at variable interest rates. These variable interest rates may be set on the first day of each month or mid-month. Line of credit loans are typically revolving facilities and generally require the borrower to pay off the principal balance for at least five consecutive business days at least once during each 12-month period. Line of credit loans are also made available as interim financing when a member either receives RUS approval to obtain a loan and is awaiting its initial advance of funds or submits a loan application that is pending approval from RUS (sometimes referred to as "bridge loans"). RUS loan advances, if received, must be used to repay these interim facilities.

Syndicated line of credit loans
A syndicated loan is typically a large financing offered by a group of lenders who work together to provide funds for a single borrower. Syndicated loans are generally unsecured, floating-rate loans that can be provided on a revolving or term basis for tenors that range from several months to several years. Syndicated financing is arranged for borrowers on a case-by-case basis. CFC may act as lead lender, arranger and administrative agent for the syndicated facilities. CFC makes its best efforts to syndicate the loan requirements of borrowers in good standing. The success of such efforts depends on the financial position and credit quality of the borrower as well as market conditions.

RTFC Loan Programs
At May 31, 2011 and 2010, 95 percent and 88 percent of RTFC loans, respectively, were outstanding to rural local exchange carriers. Most of these rural local exchange carriers evolved from solely being voice service providers to

being providers of voice, data and, in many cases, video and wireless services. Rural local exchange carriers are generally characterized by the low population density of their service territories. Services are generally delivered over networks that include fiber optic cable and digital switching. There is generally a significant barrier to competitive entry.

The businesses to which the remaining RTFC loans have been made support the operations of the rural local exchange carriers and are owned, operated or controlled by rural local exchange carriers. Many such loans are supported by payment guarantees from the sponsoring rural local exchange carriers.

Long-Term Loans
RTFC makes long-term loans to rural telecommunications companies and their affiliates for the acquisition, construction or upgrade of wireline telecommunications systems, wireless telecommunications systems, fiber optic networks, cable television systems and other corporate purposes.

RTFC's long-term loans generally have the following characteristics:

- terms not exceeding 10 years on a senior secured basis;
- the property, plant and equipment financed by and securing the long-term loan has a useful life equal to or in excess of the loan maturity;
- flexibility for the borrower to select a fixed interest rate for periods from one year to the final loan maturity or a variable interest rate; and
- the ability for the borrower to select various tranches with either a fixed or variable interest rate for each tranche.

When a selected fixed interest rate term expires, the borrower may select another fixed-rate term or a variable rate. The fixed rate on a loan is determined on the day the loan is advanced or converted to a fixed rate based on the term selected. The long-term variable rate is set on the first day of each month.

To borrow from RTFC, a wireline telecommunications system generally must be able to demonstrate the ability to achieve and maintain an annual debt service coverage ratio and an annual times interest earned ratio ("TIER") of 1.25 and 1.50, respectively. To borrow from RTFC, a cable television system, fiber optic network or wireless telecommunications system generally must be able to demonstrate the ability to achieve and maintain an annual debt service coverage ratio of 1.25.

Line of credit loans

Line of credit loans are generally unsecured. Line of credit loans are designed primarily to assist borrowers with liquidity and cash management and are generally advanced at variable interest rates. These variable interest rates may be set on the first day of each month or mid-month. Line of credit loans are typically revolving facilities and generally require the borrower to pay off the principal balance for at least five consecutive business days at least once during each 12-month period. Line of credit loans are also made available as interim financing, or bridge loans, when a member either receives RUS approval to obtain a loan and is awaiting its initial advance of funds or submits a loan application that is pending approval from RUS. RUS loan advances, if received, must be used to repay these interim facilities.

NCSC Loan Programs

Long-Term Loans

NCSC's long-term loans generally have the following characteristics:

- terms of up to 35 years on a senior secured or unsecured basis;
- amortizing or bullet maturity loans with serial payment structures;
- the property, plant and equipment financed by and securing the long-term loan has a useful life equal to or in excess of the loan maturity;
- flexibility for the borrower to select a fixed interest rate for periods of one to 35 years or a variable rate; and
- the ability for the borrower to select various tranches with either a fixed or variable interest rate for each tranche.

NCSC allows borrowers to select a fixed interest rate or a variable interest at the time of each advance on long-term loan facilities. When selecting a fixed rate, the borrower has the option to choose a fixed rate for a term of one year through the final maturity of the loan. When the selected fixed interest rate term expires, the borrower may select another fixed rate for a term of one year through the loan maturity or the current variable rate. NCSC sets long-term fixed rates daily for new loan advances and loans that reprice. The long-term variable rate is set on the first day of each month. The fixed rate on a loan is determined on the day the loan is advanced or repriced based on the term selected.

Line of credit loans

Line of credit loans are generally unsecured. Line of credit loans are designed primarily to assist borrowers with liquidity and cash management and are generally advanced at variable interest rates. These variable interest rates may be set on the first day of each month or mid-month. Line of credit loans are typically revolving facilities and generally require the borrower to pay off the principal balance for at least five consecutive business days at least once during each 12-month period. Line of credit loans are also made available as interim financing, or bridge loans, when a member either receives RUS approval to obtain a loan and is awaiting its initial advance of funds or submits a loan application that is pending approval from RUS. RUS loan advances, if received, must be used to repay these interim facilities.

Interest Rates on Loans

As a member-owned cooperative finance company, we are a cost-based lender. Our interest rates are set primarily based on our cost of funding, general and administrative expenses, loan loss provision and to provide a reasonable level of earnings. Various standardized discounts may reduce the stated interest rates for Class A and Class B borrowers meeting certain criteria related to business type, performance, volume and whether they borrow only from us.

The table below shows the weighted-average loans outstanding to borrowers and the weighted-average yield earned by loan and borrower type during fiscal years ended May 31:

	2011		2010	
(dollar amounts in thousands)	Weighted-average loans outstanding	Weighted-average yield	Weighted-average loans outstanding	Weighted-average yield
Total by loan type:				
Long-term fixed-rate loans	$ 16,297,697}	5.55%	$15,456,301	5.81%
Long-term variable-rate loans	914,979}	4.98	1,609,562	4.68
Line of credit loans	1,415,919}	3.13	1,652,154	3.39
Restructured loans	487,570}	0.57	521,570	0.61
Non-performing loans	242,890}	0.06	523,813	-
Total loans	$ 19,359,055}	5.15	$19,763,400	5.22
Total by borrower type:				
CFC	$ 17,787,856}	5.15%	$17,681,663	5.29%
RTFC	1,107,287}	4.98	1,718,100	4.21
NCSC	463,912}	5.68	363,637	6.61
Total	$ 19,359,055}	5.15	$19,763,400	5.22

Credit Policies, Process and Monitoring

Loan Underwriting and Credit Monitoring

We have separate lending staff to underwrite distribution loans, power supply loans and telecommunications loans. Our borrowers contact the applicable lending staff to discuss the member’s need for funding. Our lending staff evaluates the borrower’s request to determine whether the requested credit represents an acceptable credit risk. When considering credit requests to borrowers with large single-obligor exposures we may use loan syndications to effectively manage portfolio risk related to credit concentrations. The lending staff evaluation of the proposed credit will include, but is not limited to:

- the size of the loan request;
- the intended use of proceeds;
- whether collateral is required and, if so, whether there is sufficient collateral;
- the member’s risk profile as measured by financial ratios and other risk characteristics; and
- other factors that might be applicable to the type of borrower or the specific loan request being considered.

If our lending staff determines that a credit is acceptable, the staff works with the borrower to structure a loan based on the various options we offer and prepares a credit recommendation for review by management in the lending group as discussed further below under Loan Approval.

Our Credit Risk Management group facilitates the activities of our internal credit review process, establishes credit policies and oversees our internal risk rating system. We maintain an internal risk rating system that produces a borrower rating and a facility rating. The borrower risk rating measures risk of default for each borrower based on both quantitative and qualitative measurements specific to the particular business line of the borrower. The facility risk rating measures risk of loss in the event of default for a particular facility based on the collateral or guarantee associated with the loan. Risk ratings are used to assess the credit quality of each of our borrowers and to establish credit limitations, and are factors in determining applicable credit approval levels.

Risk ratings for borrowers with outstanding and/or unadvanced loan or guarantee commitments are updated at least annually upon the receipt of audited financial information and are reviewed in connection with any new credit request. Annually, an outside banking consultant conducts a review of the accuracy of specific borrower risk ratings and the risk rating process and credit extension practices for compliance with policy and consistency in application. Such consultant provides recommendations to management and the Board of Directors for improvement, as well as progress on the resolution of items from prior reviews. Management is responsible for implementing the recommendations accepted by the Board of Directors. In addition, we compare our internal ratings to the publicly available ratings for our members that have public ratings.

Loan Approval

Our Board of Directors establishes our loan policies, which include a credit approval matrix. The credit approval matrix specifies the required level of approval applicable to any proposed loan based on factors such as the amount of the loan, the borrower risk rating, whether credit limitations are exceeded and whether the loan is to a member associated with one of our current directors. Through the approval matrix, the Board has delegated the authority to approve certain loans to the Chief Executive Officer, who has further delegated approval authority to the Corporate Credit Committee and management in the lending group while retaining sole authority to approve certain loans.

In order to maintain our ability to consider and approve loans and other extensions of credit on a timely basis, the Board of Directors has established a loan committee, made up of Board members, that it is authorized to approve loans that require Board approval in between regularly scheduled Board meetings.

Loans that require approval at a more senior level than management in the lending group are forwarded to the Corporate Credit Committee for consideration. The Corporate Credit Committee is a cross-functional group that includes staff with distribution, power supply and telecommunications lending experience, credit risk management experience, legal experience, accounting experience, regulatory experience and financial industry experience. This committee performs a vital role in maintaining a balance between the credit needs of the borrowers and the requirements for sound credit quality of our loan and guarantee portfolio. The Corporate Credit Committee monitors lending policies and practices and reviews extensions of credits requiring special attention. The Corporate Credit Committee also monitors selected rating changes, analyzes rating integrity and works to improve our internal risk rating system. Lending staff presents the credit recommendation and answers any questions posed by the committee. The Corporate Credit Committee then approves or rejects the loan. Loans that require Chief Executive Officer or Board approval are provided with documentation and a credit recommendation by management in the lending group and the Corporate Credit Committee. The Chief Executive Officer or Board of Directors (or the loan committee of the Board) reviews the credit recommendation, asks questions of staff if necessary and either approves or rejects the loan request.

Board policy requires that any exceptions to applicable credit limitations and any loan or extension of credit to a member that has a CFC director as one of its directors or officers must be approved by the Board of Directors or the loan committee of the Board, with the director associated with the member requesting the loan being recused from discussions and voting. Notwithstanding the foregoing, the Chief Executive Officer has the authority to approve emergency and certain other lines of credit, including circumstances where a director is either a director or officer of the member receiving such credit. Such lines of credit must meet specific qualifying criteria and must be underwritten in accordance with the prevailing standards and terms.

Non-performing loans

The Credit Risk Management group, on an ongoing basis, and the Corporate Credit Committee, on a quarterly basis, monitor all past due, non-accrual and restructured facilities that are not performing under their original terms. The Credit Risk Management group presents reports on such matters to the CFC Board of Directors. Once a borrower is classified as non-performing, we typically place the loan on non-accrual status and reverse all accrued and unpaid interest back to the date of the last payment.

All loans are written off in the period that it becomes evident that collectability is highly unlikely; however, our efforts to recover all charged-off amounts may continue. Management makes a recommendation to the CFC Board or Directors as to the timing and amount of loan write-offs based on various factors, including, but not limited to, cash flow analysis and the fair value of the collateral securing the borrower's loans. The Board of Directors makes the final determination as to all loan write-offs.

Advances on Previously Approved Loan Facilities

Certain of our loan facilities allow our members to draw down the loan amount over a period of time. To advance an amount under an approved loan facility, a member must be in compliance with all terms and conditions of their facility. The majority of our loans allow us to deny an advance if there has been a material adverse change in the business condition, financial or otherwise, of the borrower since the time the facility was approved.

Covenant Compliance

Borrowers are required to maintain certain financial ratios. In addition, members with long-term loans outstanding are generally required to provide us with certain information and documentation on an annual basis, including, but not limited to, audited financial statements and a certificate of management confirming compliance with all covenants.

Loan Portfolio Performance

At May 31, 2011, there was one borrower not current with regard to its required loan payments. In general, our electric cooperative borrowers provide essential services and are insulated to some extent from the problems other companies may experience with regard to collection of amounts due during periods of recession. As a result, the difficult economic conditions experienced in recent years have not resulted in a significant rise in delinquencies or defaults in our borrowers' receivables. For calendar year 2010, our electric member systems did not report a significant increase in late payments of utility bills from their member rate-payers or write-offs. Since the start of the financial crisis in September 2008, only one electric cooperative borrower has gone into payment default.

During the three-year period ended May 31, 2011, only five borrowers were in default of loan payments, four of which were telecommunications borrowers. During the past three years, we wrote off $360 million related to three of the telecommunications borrowers, including $354 million for Innovative Communication Corporation ("ICC") during fiscal year 2011. Two smaller write-offs totaled $6 million in fiscal year 2009. There were no loan write-offs in fiscal year 2010. An electric distribution cooperative in payment default is in the process of developing geothermal generation capability and had non-performing loans outstanding of $31 million and $25 million at May 31, 2011 and 2010, respectively. This borrower filed for bankruptcy in September 2010. We had no other loans for which payments were more than 30 days delinquent at May 31, 2011. All loans classified as restructured are making payments as scheduled by the restructured agreements. See Note 3, Loans and Commitments, for additional information on our restructured and non-performing loans.

Our total loans outstanding increased by $298 million over the last three years ended May 31, 2011. The total loans outstanding increased by $1,161 million during fiscal year 2009 and decreased by $850 million and $13 million during fiscal years 2010 and 2011, respectively. The $13 million decrease in fiscal year 2011 was due to the $813 million decrease in RTFC loans outstanding, partially offset by the increases of $627 million and $173 million to loans outstanding to CFC and NCSC borrowers, respectively. The loans outstanding to CFC and NCSC borrowers increased due to a total of $1,109 million of loan advances used to refinance the debt of other lenders. This increase in loans outstanding was partly offset during fiscal year 2011 by distribution and power supply loans sold to the Federal Agricultural Mortgage Corporation totaling $327 million, of which $164 million were advanced at the time of sale, and by $75 million of loans prepaid at their repricing date. RTFC loans as a percentage of our total loan portfolio decreased from 9 percent at May 31, 2010 to 4 percent at May 31, 2011 as a result of the $536 million reduction in non-performing loans to ICC, and the prepayment of $204 million of telecommunications loans related to the acquisition of one of our borrowers.

Since we are limited to doing business with our members and associates, the growth in our loan portfolio is dependent on our members' need for capital funding and the options available to them to obtain such funding. Thus, it is very difficult to predict, with any certainty, the amount of new loan advances that will occur over the next 12 to 18 months. This is especially true with the balance of line of credit loans, which are used by our members to manage liquidity or for interim financing in anticipation of obtaining long-term RUS loans. In many cases, these interim lines of credit carry relatively large balances.

Credit Concentration

Total loans outstanding by state or U.S. territory based on the location of the system's headquarters are summarized below at May 31:

(dollar amounts in thousands)

State/Territory	2011	2010	2009	State/Territory	2011	2010	2009
Alabama	$ 442,174	$ 400,037	$ 430,065	Montana	$ 115,407	$ 128,037	$ 128,563
Alaska	384,363	350,522	340,861	Nebraska	18,469	13,420	13,844
American Samoa	-	470	489	Nevada	168,411	158,137	171,754
Arizona	205,312	239,186	246,171	New Hampshire	103,658	120,968	132,741
Arkansas	544,876	558,493	615,429	New Jersey	15,843	18,090	18,806
California	25,002	27,588	37,270	New Mexico	88,071	27,791	32,254
Colorado	937,084	937,982	944,938	New York	20,852	16,560	14,523
Connecticut	200,000	200,000	200,000	North Carolina	508,617	392,872	468,240
Delaware	26,039	27,223	36,253	North Dakota	138,788	113,668	68,758
District of Columbia	8,826	9,069	9,298	Ohio	378,027	367,607	444,565
Florida	559,880	586,228	651,564	Oklahoma	529,591	520,302	500,189
Georgia	1,542,093	1,473,464	1,584,178	Oregon	309,006	300,871	303,926
Hawaii	7,214	9,229	6,443	Pennsylvania	400,330	379,504	375,549
Idaho	151,287	154,996	158,013	South Carolina	518,224	435,156	464,125
Illinois	715,296	728,541	661,632	South Dakota	169,122	153,815	142,582
Indiana	633,245	637,271	839,473	Tennessee	59,213	68,158	76,553
Iowa	419,769	557,553	493,722	Texas	3,512,178	3,114,889	3,332,283
Kansas	791,092	822,599	801,389	Utah	558,351	569,537	561,050
Kentucky	373,809	285,166	472,693	Vermont	59,269	66,049	79,131
Louisiana	287,826	334,339	388,490	Virgin Islands	-	536,026	523,758
Maine	7,933	11,416	4,093	Virginia	386,849	357,377	201,798
Maryland	203,973	223,779	216,468	Washington	167,533	182,471	161,099
Michigan	179,082	218,037	279,490	West Virginia	2,628	2,921	2,341
Minnesota	775,984	785,774	792,863	Wisconsin	414,891	418,361	418,898
Mississippi	378,518	400,138	422,625	Wyoming	109,436	115,759	121,011
Missouri	771,235	780,959	795,956	Total	$19,324,676	$19,338,405	$20,188,207

The service territories of our electric and telecommunications members and associates are located throughout the United States and its territories, including 49 states, the District of Columbia, American Samoa and Guam. Our members provide essential electric and telecommunications services to customers in rural areas covering approximately 70 percent of the land mass of the contiguous United States. Each system is separate from other systems and there is significant variance in the size of each system, thus each system's capital requirements vary. At May 31, 2011, 2010 and 2009, loans outstanding to any one borrower did not exceed 2.6 percent, 2.7 percent and 2.6 percent, respectively, of total loans outstanding. At May 31, 2011, the top 10 borrowers held 17 percent of total loans outstanding compared with 18 percent of total loans outstanding at May 31, 2010 and 2009.

At May 31, 2011, 2010 and 2009, the largest concentration of loans to borrowers in any one state was in Texas, which had approximately 18 percent, 16 percent and 17 percent, respectively, of total loans outstanding. No other state had a loan concentration exceeding 8 percent at May 31, 2011, 2010 and 2009. Two primary factors contributed to Texas having the largest percentage of total loans outstanding compared with other states at May 31, 2011:

- Texas has the largest number of total borrowers compared with other states (see table on page 16); and
- Texas has the largest number of power supply systems (10 of our 71 power supply systems), which require significantly more capital than distribution systems and telecommunications systems.

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

Total exposure, as defined by the policies, generally includes the following:

- loans outstanding, excluding loans guaranteed by RUS;
- our guarantees of the borrower's obligations;
- unadvanced loan commitments;
- borrower guarantees to us of another borrower's debt; and
- any other indebtedness with us, unless guaranteed by the U.S. government.

The calculation of total exposure includes facilities that are approved but not yet closed and facilities that might not be drawn by the borrower, such as lines of credit and loan commitments for projects that may be delayed or eventually cancelled.

Unadvanced Loan Commitments

Unadvanced commitments represent approved and executed loan contracts for which the funds have not been advanced. At May 31, 2011, 2010 and 2009, we had the following amount of unadvanced commitments on loans to our borrowers.

(dollar amounts in thousands)	2011	% of Total	2010	% of Total	2009	% of Total
Long-term	$ 5,461,484}	39%	$ 5,154,990	36%	$ 5,609,977	41%
Line of credit	8,609,191}	61	9,039,448	64	7,941,146	59
Total	$ 14,070,675}	100%	$ 14,194,438	100%	$ 13,551,123	100%
CFC	$ 13,074,685}	93%	$ 13,248,732	93%	$ 12,804,021	95%
RTFC	366,060}	3	441,719	3	457,022	3
NCSC	629,930}	4	503,987	4	290,080	2
Total	$ 14,070,675}	100%	$ 14,194,438	100%	$ 13,551,123	100%

A total of $999 million and $931 million of line of credit unadvanced commitments at May 31, 2011 and 2010, respectively, represented unadvanced commitments related to line of credit loans that are not subject to a material adverse change clause at the time of each loan advance. As such, we would be required to advance amounts on these committed facilities as long as the borrower is in compliance with the terms and conditions of the loan.

The remaining available amounts at May 31, 2011 and 2010 were generally subject to material adverse change clauses. Prior to making an advance on these facilities, we confirm that there has been no material adverse change in the business condition, financial or otherwise, of the borrower since the time the loan was approved and confirm that the borrower is currently in compliance with loan terms and conditions.

Unadvanced commitments related to line of credit loans are typically for periods not to exceed five years and are generally revolving facilities used for working capital and backup liquidity purposes. Historically, we have experienced a very low utilization rate on line of credit loan facilities, whether or not there is a material adverse change clause.

Since we generally do not charge a fee on the unadvanced portion of the majority of our loan facilities, our borrowers will typically request long-term facilities to cover maintenance and capital expenditure work plans for periods of up to five years and draw down on the facility over that time. In addition, borrowers will typically request an amount in excess of their immediate estimated loan requirements to avoid the expense related to seeking additional loan funding for unexpected items.

The above items all contribute to our expectation that a large portion of the unadvanced commitments reported at May 31, 2011 will expire without being utilized.

Conversion of Loans

A borrower may convert a long-term loan from a variable interest rate to a fixed interest rate at any time without a fee. Generally, a borrower may convert its long-term loan from a fixed rate to another fixed rate or to a variable rate at any time in exchange for a fee plus a make-whole premium, if applicable, based on current loan policies.

Prepayment of Loans

Generally, borrowers may prepay long-term fixed-rate loans at any time, subject to a prepayment fee and a make-whole premium, if applicable. Generally, long-term variable-rate loans may be prepaid at any time, subject to a prepayment fee. Line of credit loans may be prepaid at any time without a fee, unless the interest rate on the loan is fixed or based on a LIBOR index.

Loan Security

Long-term loans are typically senior secured on parity with other secured lenders (primarily RUS), if any, by all assets and revenue of the borrower, though utility mortgages are subject to standard liens such as those related to taxes, worker's compensation awards, mechanics' and similar liens, rights-of-way, governmental rights and judgment liens. We are able to obtain liens on parity with liens for the benefit of RUS even where the RUS loan was made earlier in time than ours because RUS's form of mortgage expressly provides for other lenders such as us to have a parity lien position if the borrower satisfies certain conditions or obtains a written lien accommodation from RUS. When we make loans to borrowers that have existing loans from RUS, we generally require those borrowers either to obtain such a lien accommodation or to satisfy the conditions necessary for our loan to be secured on parity under the mortgage with the loan from RUS.

Our line of credit loans are generally unsecured. Line of credit loans are generally to provide a source of working capital, and thus it is market practice that line of credit loans are not secured.

The following tables summarize our secured and unsecured loans outstanding by loan and borrower type at May 31:

(dollar amounts in thousands)	2011				2010			
Total by loan type:	Secured	%	Unsecured	%	Secured	%	Unsecured	%
Long-term fixed-rate loans	$ 15,583,068	95 %	$ 821,872	5 %	$ 14,799,859}	96%	$ 613,128}	4 %
Long-term variable-rate loans	1,207,580	94	70,811	6	1,994,664}	95	94,165}	5
Loans guaranteed by RUS	226,695	100	-	-	237,356}	100	-}	-
Line of credit loans	107,193	8	1,307,457	92	265,427}	17	1,333,806}	83
Total loans	$ 17,124,536	89	$ 2,200,140	11	$ 17,297,306}	89	$ 2,041,099}	11
Total by borrower type:								
CFC	$ 16,180,454	90 %	$ 1,761,025	10%	$ 15,585,788}	90%	$ 1,729,241}	10%
RTFC	628,020	73	231,102	27	1,429,982}	86	241,911}	14
NCSC	316,062	60	208,013	40	281,536}	80	69,947}	20
Total loans	$ 17,124,536	89	$ 2,200,140	11	$ 17,297,306}	89	$ 2,041,099}	11

Guarantee Programs

When we guarantee debt obligations for our members, we use the same credit policies and monitoring procedures for guarantees as 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 by the guarantee beneficiary based upon a payment default by a member system. In general, the member system is required to repay, on demand, any amount advanced by us with interest, pursuant to the documents evidencing the member system's reimbursement obligation. The following table provides a breakout of guarantees outstanding by type and member class at May 31:

(dollar amounts in thousands)	2011	2010

Total by guarantee type:		
Long-term tax-exempt bonds	$ 599,935}	$ 601,625}
Indemnifications of tax benefit transfers	59,895}	69,982}
Letters of credit	327,201}	380,076}
Other guarantees	117,957}	119,426}
Total	$ 1,104,988}	$ 1,171,109}

Total by member class:				
CFC:	2011		2010	
Distribution	$ 217,099}	20%	$ 221,903}	19%
Power supply	817,618}	74	884,828}	75
Statewide and associate	20,807}	2	22,032}	2
CFC Total	1,055,524}	96	1,128,763}	96
RTFC	821}	-	636}	-
NCSC	48,643}	4	41,710}	4
Total	$ 1,104,988}	100%	$ 1,171,109}	100%

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Guarantees of Long-Term Tax-Exempt Bonds

We guarantee debt issued for our members' construction or acquisition of pollution control, solid waste disposal, industrial development and electric distribution facilities. Governmental authorities issue such debt on a non-recourse basis to the government authority and the interest thereon is exempt from federal taxation. The proceeds of the offering are made available to the member system, which in turn is obligated to pay the governmental authority amounts sufficient to service the debt. The debt we guarantee may include short- and long-term obligations.

If a system defaults for failure to make the debt payments, we are obligated to pay, after available debt service reserve funds have been exhausted, scheduled debt service under our guarantee. Such payment will prevent the occurrence of an event of default that would otherwise permit acceleration of the bond issue. The system is required to repay, on demand, any amount that we advance pursuant to our guarantee plus interest on that advance. This repayment obligation, together with the interest thereon, is typically senior secured on a parity with other lenders (including, in most cases, RUS), by a lien on substantially all of the system's assets. If the security instrument is a common mortgage with RUS, then in general, we may not exercise remedies for up to two years following default. However, if the debt is accelerated under the common mortgage because of a determination that the related interest is not tax-exempt, the system's obligation to reimburse us for any guarantee payments will be treated as a long-term loan. The system is required to pay us initial and/or ongoing guarantee fees in connection with these transactions.

Certain guaranteed long-term debt bears interest at variable rates that are adjusted at intervals of one to 270 days, weekly, each five weeks or semi-annually to a level favorable to their resale or auction at par. If funding sources are available, the member who issued the debt may choose a fixed interest rate on the debt. When the variable rate is reset, holders of variable-rate debt have the right to tender the debt for purchase at par. In some transactions, we have committed to purchase this debt as liquidity provider if it cannot otherwise be remarketed. If we hold the securities, the cooperative pays interest to us at our short-term variable interest rate. At May 31, 2011 and 2010, we were the guarantor and liquidity provider for $524 million and $549 million, respectively, of tax-exempt bonds issued for our member cooperatives. During the years ended May 31, 2011 and 2010, we were not required to purchase any tax-exempt bonds pursuant to our obligation as liquidity provider.

Guarantees of Tax Benefit Transfers

We also have guaranteed members' obligations to indemnify against loss of tax benefits in certain tax benefit transfers that occurred in 1981 and 1982. A member's obligation to reimburse us for any guarantee payments would be treated as a long-term loan, secured on a parity with RUS by a first lien on substantially all of the member's property to the extent of any cash received by the member at the outset of the transaction. The remainder would be treated as a line of credit loan secured by a subordinated mortgage on substantially all of the member's property. Due to changes in federal tax law, no guarantees of this nature have been put in place since 1982.

Letters of Credit

In exchange for a fee, we issue irrevocable letters of credit to support members' obligations to energy marketers, other third parties and to the Rural Business and Cooperative Development Service. Letters of credit may be on a secured or unsecured basis. Each letter of credit is supported by a reimbursement agreement with the member on whose behalf the letter of credit was issued. In the event a beneficiary draws on a letter of credit, the agreement generally requires the member to reimburse us within one year from the date of the draw, with interest accruing from that date at our line of credit variable interest rate.

Other Guarantees

We may provide other guarantees as requested by our members. These guarantees may be made on a secured or unsecured basis with guarantee fees set to cover our general and administrative expenses, a provision for losses and a reasonable margin.

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Total guarantees outstanding by state and territory based on the location of the system's headquarters, is summarized as follows at May 31:

(dollar amounts in thousands)

State/Territory	2011	2010	2009	State/Territory	2011	2010	2009
Alabama	$195,124	$198,018	$198,506	Missouri	$ 54,999	$ 61,151	$ 68,363
Alaska	6,757	3,884	3,860	Montana	88	71	12,772
American Samoa	1	1	-	Nebraska	7	11	7
Arizona	26,674	29,967	29,869	Nevada	51,099	47,018	37,452
Arkansas	2,425	4,309	6,166	New Hampshire	20,213	26,063	24,763
California	269	333	6,247	New Mexico	11,456	1,025	1,036
Colorado	51,239	51,964	52,690	New York	79	96	113
Delaware	8	12	8	North Carolina	100,699	105,871	105,905
District of Columbia	13,000	14,900	16,000	North Dakota	4,529	5,197	5,825
Florida	11,169	12,058	2,851	Ohio	3,004	4,005	7,000
Georgia	25,339	27,890	23,718	Oklahoma	823	800	764
Hawaii	1,300	1,300	1,300	Oregon	23,605	23,452	28,511
Idaho	-	-	3,173	Pennsylvania	11,593	12,622	18,747
Illinois	62,900	79,854	82,927	South Carolina	835	645	506
Indiana	24	19	23	South Dakota	8	24	19
Iowa	7,465	6,269	6,961	Tennessee	4,573	3,747	3,939
Kansas	37,664	39,632	41,318	Texas	182,836	219,754	216,443
Kentucky	67,932	82,562	91,741	Utah	-	-	6,961
Louisiana	244	407	501	Vermont	2,100	1,100	1,350
Maine	8	9	4	Virginia	2,213	2,552	2,874
Maryland	27,028	37,048	52,078	Washington	11	9	19,050
Michigan	2,132	5,131	5,236	Wisconsin	24,317	452	305
Minnesota	2,153	1,576	1,601	Wyoming	2	5	4,829
Mississippi	65,044	58,296	81,143	Total	$1,104,988	$1,171,109	$1,275,455

Our Lending Competition

Electric Lending

RUS is the largest lender to electric cooperatives. RUS provides long-term secured loans. CFC offers its members financial products and services that supplement and complement those of RUS and, therefore, CFC does not consider RUS to be a competitor. CFC competes with banks to make bridge loans that are needed by electric cooperatives in anticipation of obtaining long-term funding from RUS, the portion of a loan that RUS is unable to provide, and loans to members that have elected not to borrow from RUS. For the fiscal year ending September 30, 2011, authorized lending levels under the RUS electric loan program were $100 million for hardship loans and $6,500 million for loan guarantees.

Our main competitor is CoBank, ACB, a federally chartered instrumentality of the United States that is a member of the Farm Credit System. As a government-sponsored enterprise, CoBank, ACB, has the benefit of an implied government guarantee. In addition, members may obtain funding from commercial banks or may be large enough to directly access the capital markets for funding. As a result, we are competing with the pricing and funding options the member is able to obtain from these sources. We attempt to minimize the effect of competition by offering a variety of loan options and value-added services and by leveraging the working relationship we have developed with the majority of our members.

In order to meet the unique needs of our members, we offer options including credit support in the form of letters of credit and guarantees, large transaction management and loan sales to other financial institutions. Credit products are tailored to meet specific transaction structures and are often designed to cover gaps left by other lenders, such as bridge loans to long-term financing provided by RUS. CFC also offers certain risk mitigation products and interest rate discounts on secured, long-term loans for its members that meet certain criteria, including performance, volume, collateral and equity requirements.

CFC has established certain funds to benefit its members. Since 1981, CFC has set aside a portion of its annual margins in a cooperative educational fund to promote awareness and appreciation of the cooperative principles. As directed by CFC’s Board of Directors, the contributions to the funds are distributed through the electric cooperative statewide associations. Since 1986, CFC has supported its members’ efforts to protect their service territories from erosion or takeover by other utilities through assistance from the Cooperative System Integrity Fund. This program is funded through voluntary contributions from members, and amounts are distributed to applicants that establish that all or a significant portion of their consumers, services or facilities face a hostile threat of acquisition or annexation by a competing entity, or that it faces a significant threat in its ability to continue to provide electric or other energy services to customers.

CFC also offers its members additional services to enhance member operations including:

- Return of net earnings through the retirement of patronage capital. The laws of the District of Columbia require CFC to allocate but not retire patronage capital. However, CFC maximizes members' returns by retiring patronage capital to members to significantly reduce their effective cost of borrowing each year based on approval by its Board of Directors.

- CFC Paying Agent Service. CFC's Paying Agent Service allows members to enhance their cash management abilities so that they can earn interest until the moment the money is needed to make loan payments, cover power bill costs or pay other ongoing costs.

- CFC Key Ratio Trend Analysis. CFC issues a report annually that provides members information about where their operations stand in relation to other electric systems or power suppliers of similar size, location and growth characteristics. The report provides a five-year review of rural electric trends in nine key planning areas and supports decision-making by our members' managers and boards.

- CFC RateWatch™. This service allows members to monitor certain interest rates and alerts borrowers when fixed rates reach a maximum or minimum level specified by the borrower. Members can lock in a current interest rate for any term specified on expected future borrowings to mitigate risk, subject to certain fees. Borrowers with variable-rate loans are notified when fixed rates reach the selected level and have the option of converting at that time or of resetting CFC RateWatch at a new level. CFC offers this service free of charge.

- Regulatory support services. This service is available for members and includes, but is not limited to, assistance with rate design, expert testimony, cost-of-service analysis and strategic regulatory planning.

- Conferences, meetings and workshops. CFC produces a range of programs each year providing in-depth information and insight on utility and energy issues, financing and economic trends and outlooks, and management and leadership best practices. These programs also provide opportunities for members' directors and employees to network with CFC staff and with their peers at other cooperatives, while simultaneously earning professional education credits.

- CFC Extranet. The CFC extranet provides borrowers with a convenient way to view their loan and investment history with CFC. In addition, the website provides useful financial tools for members to analyze various aspects of their businesses. Members also can make investments in CFC and request loan advances online.

Our rural electric borrowers are mostly private companies, thus the overall size of the rural electric lending market cannot be determined from public information. We estimate the size of the overall rural electric lending market from the annual financial and statistical reports filed with us by our members using calendar year data; however, there are certain limitations with regard to these estimates, including the following:

- while the underlying data included in the financial and statistical reports may be audited, the preparation of the financial and statistical reports is not audited;
- in some cases, not all members provide the annual financial and statistical reports on a timely basis to be included in summarized results; and
- the financial and statistical reports do not include indebtedness by lender other than RUS.

According to financial data provided to us by our 810 reporting distribution systems and 59 reporting power supply systems as of December 31, 2010, and our 808 reporting electric cooperative distribution systems and 56 reporting power supply systems as of December 31, 2009, long-term debt outstanding to CFC, RUS and other lenders in the electric cooperative industry by those entities was as follows:

(dollar amounts in thousands)	2010	2009
Total long-term debt reported by members	$ 74,798,340	$ 70,091,418
Less: long-term debt funded by RUS	(36,653,484)	(36,032,467)
Members' non-RUS long-term debt	$ 38,144,856	$ 34,058,951

	2010	% of Total	2009	% of Total
Long-term debt funded by CFC	$16,998,173	45%	$15,905,971	47%
Long-term debt funded by other lenders	21,146,683	55	18,152,980	53
Members' non-RUS long-term debt	$38,144,856	100%	$34,058,951	100%

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Members' long-term debt funded by CFC is further summarized by type below at December 31:

(dollar amounts in thousands)	2010	% of Total	2009	% of Total
Distribution	$13,373,765	79%	$12,704,496	80%
Power supply	3,624,408	21	3,201,475	20
Long-term debt funded by CFC	$16,998,173	100%	$15,905,971	100%

We are not able to specifically identify the amount of debt our members have outstanding to CoBank, ACB, from either the annual financial and statistical reports filed with us or CoBank, ACB's public disclosure, but we believe that CoBank, ACB, is the lender other than CFC and RUS with significant long-term debt outstanding to the rural electric cooperatives.

Telecommunications Lending

In 1949, the Rural Electrification Act was amended to allow lending for the establishment and improvement of rural telecommunications service. For fiscal year 2011, RUS has $690 million in annual lending authority for its traditional plant modernization and upgrade lending program of direct loans to rural telephone systems and $325 million of authority under the RUS broadband loan program that Congress created in 2002. In addition, the American Recovery and Reinvestment Act of 2009 provided RUS with $2,500 million of budget authority for loans and grants and the Department of Commerce's National Telecommunications and Information Administration with $4,700 million in budget authority for grants to support the expansion of broadband service into unserved and underserved areas.

RTFC is not in direct competition with RUS, but rather competes with other lenders for supplemental lending and for the full lending requirement of the rural telecommunications companies that decide not to borrow from RUS or for projects not eligible for RUS financing. Given the increased availability of government financing for rural broadband, it is unlikely we will participate in this financing to any significant degree outside of incremental lending to existing rural local exchange carrier borrowers to provide broadband services to their customers or interim financing in connection with the federal funding programs.

RTFC's competition includes commercial banks and CoBank, ACB. The competitive market for providing credit to the rural telecommunications industry is difficult to quantify. Many rural telecommunications companies are not borrowers of RUS or CoBank, ACB, and commercial banks generally do not publish information solely on their telecom portfolios. At December 31, 2010, RUS had approximately $3,760 million in long-term loans outstanding to telecommunications borrowers and $507 million in broadband loans. At December 31, 2010, RTFC had a total of $918 million in long-term loans outstanding to telecommunications borrowers.

Our Regulation

CFC, RTFC and NCSC are not subject to state or federal regulatory oversight or compliance with regard to lending. CFC, RTFC and NCSC are subject to state laws that pertain to the business conducted in each state, including but not limited to usury laws and laws governing mortgages.

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act, also known as the financial overhaul bill, was signed into law. The legislation strengthens the powers of regulators to monitor the financial industry and take action against failing companies that threaten the entire system. The law mandates numerous rulemakings that are expected to affect the financial industry in future periods. Of particular importance for our operations are the law's provisions imposing new requirements on certain entities that use derivatives, including requirements for margin and clearing. The law calls for the specifics of these requirements to be set forth by certain regulatory agencies in rulemakings. These rulemakings have not been completed and final rules are not expected until at least the fall of 2011. We have submitted comments in connection with various rulemakings setting forth our belief, among others, that CFC should be exempt from the derivatives clearing and margin requirements of the Dodd-Frank Act.

Until final rules are issued, it is not clear to what extent CFC's use of derivatives may be subject to additional requirements. Therefore, we cannot yet determine the full effect the law may have on us at this time. However, we anticipate that, if we are subject to the margin and clearing requirements of the Dodd-Frank Act, we may experience an increase in costs.

Our Members

At May 31, 2011, after taking into consideration systems that are members of both CFC and NCSC and eliminating memberships between CFC, RTFC and NCSC, our consolidated membership totaled 1,460 members and 262 associates.

The table below presents the total number of CFC, RTFC and NCSC members and associates and borrowers by state or U.S. territory and the percentage of total loans outstanding at May 31, 2011. The percentage of total loans is based on the aggregate principal balance of the loans outstanding.

State/Territory	Number of Members (1)	Number of Borrowers	Loan Balance %	State/Territory	Number of Members (1)	Number of Borrowers	Loan Balance %
Alabama	34	27	2.29%	Missouri	76	49	3.99%
Alaska	32	19	1.99	Montana	40	25	0.60
American Samoa	1	-	-	Nebraska	39	10	0.10
Arizona	28	12	1.06	Nevada	9	4	0.87
Arkansas	30	19	2.82	New Hampshire	4	1	0.54
California	12	5	0.13	New Jersey	2	2	0.08
Colorado	45	28	4.85	New Mexico	25	17	0.46
Connecticut	1	1	1.03	New York	21	7	0.11
Delaware	2	1	0.13	North Carolina	48	31	2.63
District of Columbia	6	2	0.04	North Dakota	38	13	0.72
Florida	23	16	2.90	Ohio	49	28	1.96
Georgia	76	47	7.98	Oklahoma	54	29	2.74
Guam	2	-	-	Oregon	44	23	1.60
Hawaii	1	1	0.04	Pennsylvania	31	16	2.07
Idaho	19	14	0.78	South Carolina	41	25	2.68
Illinois	59	30	3.70	South Dakota	50	33	0.88
Indiana	66	44	3.28	Tennessee	30	22	0.31
Iowa	123	49	2.17	Texas	120	74	18.17
Kansas	66	43	4.09	Utah	12	6	2.89
Kentucky	41	25	1.93	Vermont	8	6	0.31
Louisiana	19	11	1.49	Virginia	28	19	2.00
Maine	7	2	0.04	Washington	19	11	0.87
Maryland	3	3	1.06	West Virginia	4	2	0.01
Massachusetts	1	-	-	Wisconsin	69	26	2.14
Michigan	31	16	0.93	Wyoming	15	13	0.56
Minnesota	89	54	4.02	Total	1,722	985	100%
Mississippi	29	24	1.96				

(1) Includes associates.

CFC

Each of CFC's distribution and power supply members received or is eligible to receive financing from RUS. One of the criteria for eligibility for RUS financing is a "rural area" test. Thus, as an entity that supplements RUS financing, CFC relies on the definition of "rural" as specified in the Rural Electrification Act, as amended in 2008. "Rural" is defined in the Rural Electrification Act as any area other than a city, town or unincorporated area that has a population of more than 20,000, or is an area within the service area of a borrower with an outstanding loan made under titles I though V of the Rural Electrification Act as of the date of enactment in 2008, regardless of population. The definition of "rural" under the act permits an area to be defined as “rural” regardless of the development of such area subsequent to the approval of the outstanding loan. Thus, if an RUS borrower met the “rural area” definition at the time of its first loan origination from RUS and continues to have outstanding RUS loans, RUS has the authority to continue lending to the entity regardless of subsequent population growth in its service territory. Similar to RUS, CFC establishes eligibility only at the time a system initially borrows from CFC, and that eligibility, as it relates to the “rural area” test, is based on a determination of whether the system borrowed or is eligible to borrow from RUS.

CFC’s Bylaws provide that cooperative or nonprofit corporations, public corporations, utility districts and other public bodies that received or are eligible to receive a loan or commitment for a loan from RUS or any successor agency (as well as subsidiaries, federations or statewide and regional associations that are wholly owned or controlled by such entities) are eligible for membership. Thus, those entities that received or qualify for financing from RUS are eligible to apply for membership and subsequently borrow from CFC regardless of whether there is an outstanding loan with RUS. There are no requirements to maintain membership, although the Board has the authority to suspend a member under certain circumstances. CFC has not suspended a member to date.

CFC has the following types of members, all of which are not-for-profit entities or subsidiaries or affiliates of not-for-profit entities. All electric members provide services to both residential and commercial customers.

Class A – Distribution Systems
Cooperative or nonprofit corporations, public corporations, utility districts and other public bodies, which received or are eligible to receive a loan or commitment for a loan from RUS or any successor agency, and that are engaged or planning to engage in furnishing utility services to their members and patrons for their use as ultimate consumers. The majority of our distribution system members are consumer-owned electric cooperatives. The remaining distribution systems are governmental entities, such as public power districts, public utility districts and tribal utility authorities.

Class B – Power Supply Systems
Cooperative or nonprofit corporations that are federations of Class A members or of other Class B members, or both, or that are owned and controlled by Class A members or by other Class B members, or both, and that are engaged or planning to engage in furnishing utility services primarily to Class A members or other Class B members. Our power supply system members are member-owned electric cooperatives.

Class C – Statewide and Regional Associations
Statewide and regional associations that are wholly owned or controlled by Class A members or Class B members, or both, or that are wholly owned subsidiaries of a CFC member, and that do not furnish utility services but supply other forms of service to their members.

Class D – National Associations of Cooperatives
National associations of cooperatives that are Class A, Class B and Class C members, provided said national associations have, at the time of admission to membership in CFC, members domiciled in at least 80 percent of the states in the United States. The National Rural Electric Cooperative Association is our sole Class D member.

Associates
Nonprofit groups or entities organized on a cooperative basis that are owned, controlled or operated by Class A, B, C or D members and are engaged in or plan to engage in furnishing non-electric services primarily for the benefit of the ultimate consumers of CFC members are eligible to be an associate of CFC.

CFC Class A, B, C and D members are eligible to vote on matters put to a vote of the membership. Associates are not eligible to vote on matters put to a vote of the membership.

At May 31, 2011, CFC's membership included:

- 834 Class A distribution systems;
- 71 Class B power supply systems;
- 66 Class C statewide and regional associations, including NCSC; and
- 1 Class D national association of cooperatives.

In addition, CFC had 58 associates, including RTFC, at May 31, 2011.

RTFC
Membership in RTFC is limited to cooperative corporations, private corporations, public corporations, nonprofit corporations, utility districts and other public bodies that are approved by the RTFC Board of Directors and are actively borrowing or are eligible to borrow from RUS, and are engaged or planning to engage directly or indirectly in furnishing telecommunications services and holding companies, subsidiaries and other organizations that are owned, operated or controlled by one or more of such entities. RTFC members are eligible to vote at each meeting of the members. Entities approved by the RTFC Board of Directors that are owned, controlled or operated by members, or entities eligible to become members, are eligible to be an associate of RTFC. Associates are not eligible to vote at meetings of the members. All RTFC members provide services to both residential and commercial customers.

At May 31, 2011, RTFC's membership included 489 members and five associates. CFC is not a member of RTFC. RTFC's members and associates consist of 194 not-for-profit entities and 300 for-profit entities at May 31, 2011.

NCSC

Membership in NCSC is limited to organizations that are Class A members of CFC, or eligible for such membership, and CFC. At May 31, 2011, NCSC's membership included 370 distribution systems and CFC. All of the NCSC distribution members are also CFC members.

In addition, NCSC had 200 associates at May 31, 2011. NCSC's associates may include members of CFC, entities eligible to be members of CFC and entities that are owned, controlled or operated by or provide significant benefit to Class A, B and C members of CFC.

Corporate Governance

CFC
Pursuant to the CFC Bylaws, there are 11 districts, comprising of 10 districts for the general membership and one for the Class D membership. Pursuant to its bylaws, CFC holds an annual meeting of the members each calendar year. The Board of Directors also calls a separate meeting annually of the members in each of districts 1 to 10 for the purpose of electing a nominating committee, or electing directors or both. Each member is entitled to one vote and no more upon each matter submitted to a vote at all meetings of the members.

The business and affairs of CFC are governed by a board of up to 23 directors that exercises all of the powers of CFC except such as are by law, the Articles of Incorporation or the bylaws conferred upon or reserved to the members. The members are only entitled to vote for the election of nominating committees and directors and the removal of directors or officers, as well as amendments to the CFC Bylaws and such other matters as the Board of Directors determines appropriate to present to the members for a vote.

Each district is represented by two board members. In districts 1 to 10, one of the two positions on the Board of Directors in each district is held by a person who is a trustee or director of a member organization within the district and the other position is held by a person who is a manager of a member organization within the district. Additionally, two directors are designated by the Class D (District 11) member, the National Rural Electric Cooperative Association.

In addition to the 20 directors elected and two directors designated from the districts described above, if the Board of Directors in its discretion so determines, then there may be one additional at-large director elected to serve on the Board of Directors of CFC from time to time. The at-large director is elected by the members and serves on the Audit Committee. No person is eligible to become or remain the at-large director unless the person (i) is a trustee, director, manager, chief executive officer or chief financial officer of a member of CFC or holds a comparable position of a member of CFC, (ii) satisfies the applicable requirements of an Audit Committee financial expert and (iii) is otherwise independent in accordance with Rule 10A-3 under the Securities Exchange Act and under the New York Stock Exchange standards, which the Board of Directors adopted to evaluate the independence of our directors. Since March 2007, CFC has had such an at-large director on its Board of Directors.

Pursuant to the CFC Bylaws, the officers of CFC include a president, vice president, secretary-treasurer and such other officers as may be determined from time to time by the Board of Directors. The officers are elected annually by the Board of Directors at the first meeting of the Board of Directors held after each annual meeting. The president, vice president, and secretary-treasurer must be members of the Board of Directors.

CFC's Board of Directors is responsible for the oversight and direction of risk management, while CFC's management has primary responsibility for day-to-day management of the risks associated with CFC's business. In fulfilling its risk management oversight duties, CFC's Board of Directors receives periodic reports on business activities from executive management and from various operating groups and committees across the organization, including the Credit Risk Management group, Internal Audit group and the Corporate Compliance group, as well as the Asset Liability Committee, the Corporate Credit Committee and the Disclosure Committee. CFC's Board of Directors also reviews CFC's risk profile and management's response to those risks throughout the year at its meetings. The Board of Directors establishes CFC's loan policies and has established a loan committee of the Board comprising no fewer than

10 directors that reviews the performance of the loan portfolio in accordance with those policies. See Credit Policies, Process and Monitoring on page 6 for more information about the role of our Board of Directors in our lending business.

RTFC

The business affairs of RTFC are governed by a Board of no less than five and no more than 10 directors. Pursuant to the RTFC Bylaws, there are five districts for the membership, and no less than one director must be a director, trustee, officer or manager of a member in each of the five districts. Directors are elected at the annual meeting of the members. Each member is entitled to one vote and no more upon each matter submitted to a vote at all meetings of the members. There are no CFC directors, officers or employees that serve as a director for RTFC.

The RTFC Board of Directors established an Executive Committee of the Board of Directors pursuant to a written board policy that sets forth the delegations of responsibility, authorities and functions of the Executive Committee of the Board of

Directors. The board policy delegates to the Executive Committee the authority to advise and consult with the Chief Executive Officer with respect to the development of policies governing RTFC's making of loans, guarantees and investments to or for the benefit of members.

The RTFC Board of Directors reserves the authority to approve certain loans and guarantees based on the loan amount, credit quality and other criteria established by the Board of Directors from time to time. During intervals between Board meetings, the Executive Committee may consider and approve financing arrangements that require approval by the full Board. The Board of Directors delegates to the Chief Executive Officer or to the Chief Executive Officer's designee(s) the authority to approve certain financing arrangements up to certain dollar thresholds and with certain credit characteristics and also authorizes the Chief Executive Officer to establish an internal Corporate Credit Committee.

One of the loan policies established by RTFC's Board of Directors sets forth the loan guidelines and credit products established to implement the corporate purpose and program objectives of RTFC. Loans and guarantees are made to members, affiliates of members and associates that meet applicable financial and feasibility criteria, security requirements and conditions as established for each type of loan pursuant to RTFC's practices and procedures in effect at the time. A credit analysis is conducted by staff during the underwriting process for each application to determine if the applicant has the ability to meet its obligations and RTFC's financial standards and if the proposed structure provides adequate security for each secured credit facility. RTFC's Board of Directors delegates to the Chief Executive Officer or the Chief Executive Officer's designee(s) the authority to implement this policy.

NCSC
The business affairs of the association are governed by a Board of 11 directors. Pursuant to the NCSC Bylaws, there are five districts for the general membership and one district for CFC. The five general membership districts are represented by two directors, one of which must be a director or trustee of a member and one of which must be a manager of a member. Directors are elected at the annual meeting of the members. Each member is entitled to one vote and no more upon each matter submitted to a vote at all meetings of the members. The membership of the sixth district, or CFC, nominates one director for election by the members.

The NCSC Board of Directors established an Executive Committee of the Board of Directors pursuant to a written board policy that sets forth the delegations of responsibility, authorities and functions of the Executive Committee of the Board of Directors. The board policy delegates to the Executive Committee the authority to advise and consult with the Chief Executive Officer with respect to the development of policies governing NCSC's making of loans, guarantees and investments to or for the benefit of members.

The NCSC Board of Directors has the authority to approve certain loans and guarantees based on the loan amount, credit quality and other criteria established by the Board of Directors from time to time. During intervals between Board meetings, the Executive Committee may consider and approve financing arrangements that require approval by the full Board. The Board of Directors delegates to the Chief Executive Officer or to the Chief Executive Officer's designee(s) the authority to approve certain financing arrangements up to certain dollar thresholds and with certain credit characteristics and also authorizes the Chief Executive Officer to establish an internal Corporate Credit Committee.

One of the loan policies established by NCSC's Board of Directors sets forth the loan guidelines and credit products established to implement the corporate purpose and program objectives of NCSC. Loans and guarantees are made to members, affiliates of members and associates that meet applicable financial and feasibility criteria, security requirements, and conditions as established for each type of loan pursuant to NCSC's practices and procedures in effect at the time. A credit analysis is conducted by staff during the underwriting process for each application to determine if the applicant has the ability to meet its obligations and NCSC's financial standards and if the proposed structure provides adequate security for each secured credit facility. NCSC's Board of Directors has delegated to the Chief Executive Officer or the Chief Executive Officer's designee(s) the authority to implement this policy.

Rural Electric Industry

Since the enactment of the Rural Electrification Act in 1936, RUS has financed the construction of electric generating plants, transmission facilities and distribution systems to provide electricity to rural areas. Principally through the creation of local electric cooperatives originally financed under the Rural Electrification Act loan program in 47 states and three U.S. territories, the percentage of farms and residences in rural areas of the United States receiving central station electric service increased from 11 percent in 1934 to almost 100 percent currently. According to 2009 data from the U.S. Energy Information Administration, rural electric systems serve approximately 13 percent of all consumers of electricity in the United States and its territories and serve about seven consumers per mile of line, compared with 35 customers per mile of line for investor-owned utilities. Rural electric systems account for approximately 11 percent of total sales of electricity and own about 5 percent of the nation's electricity generating capacity.

RUS makes insured loans and loan guarantees and provides other forms of financial assistance to electric borrowers. RUS is authorized to make direct loans to systems that qualify for the hardship program (5 percent interest rate) or the municipal rate program (based on a municipal government obligation index). RUS is also authorized to guarantee loans that bear interest at a rate agreed upon by the borrower and the lender (which generally has been the Federal Financing Bank). RUS exercises financial and technical supervision over borrowers' operations. Its loans and guarantees are secured by a mortgage or indenture on substantially all of the system's assets and revenue.

Leading up to CFC's formation in 1969, there was a growing need for capital for electric cooperatives to build new electric facilities due to growth in rural America. The electric cooperatives formed CFC so a source of financing would be available to them to supplement the RUS loan programs and to mitigate uncertainty related to government funding. Providing the electric cooperatives with financial products and services to supplement the RUS loan programs remains the purpose of CFC.

CFC aggregates the combined strength of the rural electric cooperatives to access the public capital markets and fill the need to provide supplemental funding to that of RUS. CFC is owned by its consumer-owned electric cooperative members. CFC works cooperatively with RUS; however, CFC is not a federal agency or a government-sponsored enterprise, and is not owned or controlled by any federal agency or government-sponsored enterprise. Our members are not required to have outstanding loans from RUS as a condition of borrowing from CFC. CFC supplements the RUS financing programs to meet the financial needs of its rural members by:

- providing bridge loans required by borrowers in anticipation of receiving RUS funding;
- providing financial products not otherwise available from RUS including lines of credit, letters of credit, guarantees on tax-exempt financing (usually for pollution-control equipment), weather-related disaster recovery lines of credit, unsecured loans, and investment products such as commercial paper and member capital securities;
- meeting the financing needs of those rural electric systems that repay or prepay their RUS loans and replace the government loans with private capital; and
- providing financing to RUS-eligible rural electric systems for facilities that are not eligible for financing from RUS. Examples of such facilities include electric utility facilities acquired by a cooperative from an investor-owned or municipal utility for service to an area that falls outside of an eligible rural area, as defined in the Rural Electrification Act. In other cases, an RUS-eligible system obtains CFC financing for non-electric facilities used by the cooperative to serve its rural members when such facilities are not eligible for RUS loans. More recently, RUS has instituted restrictions on financing for certain baseload generation facilities. A cooperative in the process of constructing such facilities will need financing to complete this work, and because of the recent change in RUS policy, it may not be able to obtain this additional funding from RUS.

Electric Systems and Associations

Distribution Systems

Distribution systems are utilities engaged in retail sales of electricity to residential and commercial consumers in their defined service areas generally on an exclusive basis using their distribution infrastructure including substations, wires and related support systems. Distribution systems are cooperatives owned by the customers they serve. Distribution systems vary in size from small systems that serve a few thousand customers to large systems that serve more than 200,000 customers. Thus, the amount of loan funding required by different distribution systems varies significantly. Distribution systems may service customers in more than one state.

Most distribution systems have all-requirements power purchase contracts with their power supply systems, which are owned and controlled by the member distribution systems. Wholesale power for resale also comes from other sources, including power supply contracts with government agencies, investor-owned utilities and other entities, and in some cases, the distribution systems own generating facilities.

Power Supply Systems

Power supply systems are utilities that purchase or generate electric power and provide it on a wholesale basis to distribution systems for delivery to the consumer. The distribution systems are the members of the power supply systems. The power supply systems vary in size from one with hundreds of megawatts of power generation capacity to systems that have no generating capacity, which generally operate transmission lines to supply certain distribution systems or manage power supply purchase arrangements for the benefit of their distribution system members. Certain other power supply systems have been formed but do not yet own generation or transmission facilities or have financing commitments from us. Thus, the amount of loan funding required by different power supply systems varies significantly. Power supply members may serve distribution systems located in more than one state.

The wholesale power supply contracts with their distribution system members permit the power supply system, subject to regulatory approval in certain instances, to establish rates to produce revenue sufficient to meet the cost of operation and maintenance of all generation, transmission and related facilities and to pay the cost of any power and energy purchased for resale.

Statewide and Regional Associations

Each state may have an organization that represents and serves the distribution systems and power supply systems located in the state. Such statewide organizations provide training, as well as legislative, regulatory, media and related representation for the member distribution and power supply systems.

National Associations of Cooperatives

The National Rural Electric Cooperative Association represents cooperatives nationally. It provides training, sponsors regional and national meetings, and provides legislative, regulatory, media, and related representation for all rural electric cooperatives.

Electric Member Competition

The movement toward electric competition at the retail level has largely ceased. The electric utility industry has settled into a “hybrid” model in which there are significant differences in the retail regulatory approaches followed in different states and regions.

Customer choice regulation, where customers have a choice of alternative energy suppliers, has had little to no impact on distribution and power supply cooperatives, and we do not expect a material impact going forward. As of May 31, 2011, retail customer choice is active in 15 states. Those states are Connecticut, Delaware, Illinois, Maine, Maryland, Massachusetts, Michigan, New Hampshire, New Jersey, New York, Ohio, Oregon, Pennsylvania, Rhode Island and Texas. In general, even in those states, very few consumers served by CFC members have switched from the traditional supplier.

Many factors influence the choices customers have available to them and, therefore, mitigate the effect of customer choice and competition in areas served by cooperatives. These factors include, but are not limited to, the following:

- utilities in many states may still be regulated regarding rates on non-competitive services, such as distribution;
- 20 states regulate the debt securities issued by utilities, including cooperatives, which could affect funding costs and, therefore, the electric rates charged to customers;
- Federal Energy Regulatory Commission regulation of rates as well as terms and conditions of transmission service;
- the fact that few competitors demonstrated much interest in providing electric energy to residential or rural customers; and
    - distribution systems own the lines to the customer and it would not be feasible for a competitor to build a second line to serve the same customers in almost all situations. Therefore, the distribution systems still charge a fee or access tariff for the service of delivering power, regardless of who supplies the power.

Electric Member Regulation

There are 14 states that fully or partially regulate the rates electric cooperative systems charge. Those states are Arizona, Arkansas, Georgia, Hawaii, Kentucky, Louisiana, Maine, Maryland, New Mexico, New York, Utah, Vermont, Virginia and West Virginia. In these 14 states, we had 155 distribution members and 12 power supply members with a total of $4,069 million, or 21 percent, of loans outstanding at May 31, 2011, $2,034 million of which was to borrowers in Georgia and Utah that have partial oversight authority over the cooperatives’ rates, but not the specific authority to set rates. There are 11 states that allow cooperatives the right to opt in or out of state regulation. There are 20 states that regulate electric systems’ issuance of debt (although one of these states, New Mexico, does not regulate any loans to RUS borrowers). FERC also has jurisdiction to regulate transmission rates, wholesale rates, terms and conditions of service, and the issuance of securities by public utilities within its jurisdiction, which includes only a few cooperatives.

Our distribution and power supply members are subject to regulation by various federal, regional, state and local authorities with respect to the environmental effects of their operations, including air and water quality control, solid and hazardous waste disposal, and limitations on land use. At the federal level, the Environmental Protection Agency ("EPA") has been pursuing an active regulatory agenda through a substantial number of significant rulemakings. Estimates indicate that regulations affecting cooling water intake structures, coal ash disposal, interstate transport of air pollutants and hazardous air pollutants, including mercury, could force the electric utility industry to retire or retrofit between 33,000 megawatts to 70,000 megawatts of generating capacity by 2015 at a significant cost. Additionally, earlier this year the EPA began the process of regulating greenhouse gas emissions from stationary sources, including power plants. This could force measures on the industry to reduce power plant greenhouse gas emissions, which would dramatically raise the cost of electricity generated from fossil fuel plants. While legislation has been introduced in the House and Senate to either pre-empt or delay the EPA's efforts to regulate greenhouse gas emissions, its prospects for passage remain uncertain. While we cannot currently estimate projected expenditures related to these laws and regulations for our members, we believe the financial impact of these laws and regulations on our members will be passed through to their customers.

Rural Telecommunications Industry

Telecommunications systems include not-for-profit cooperative organizations and for-profit commercial organizations that primarily provide local exchange and access telecommunications services to rural areas.

Independent rural telecommunications companies provide service throughout many of the rural areas of the United States. These approximately 1,300 companies are called independent because they are not affiliated with Verizon or AT&T. Included in the 1,300 total are approximately 260 not-for-profit cooperative companies. A majority of the remainder of these independent rural telecommunications companies are privately held commercial companies. Less than 15 of these commercial companies are publicly traded or have issued bonds in the capital markets.

Rural telecommunications companies, excluding Verizon, AT&T and CenturyLink, provide service to less than 15 percent of the more than 120 million end-user switched access lines. These rural companies range in size from fewer than 100 customers to more than 5 million. Rural telecommunications companies' annual operating revenue range from less than $0.1 million to more than $3,000 million. In addition to basic local exchange and access telecommunications service, most independents offer other communications services including wireless voice and data, cable television and high-speed Internet access. Most rural telecommunications companies' networks incorporate digital switching, fiber optics, Internet protocol (IP) telephony and other advanced technologies.

Telecommunications Competition

The Telecommunications Act of 1996 created a framework for competition and deregulation in the local telecommunications market. As a result, competition continues to be a significant factor in the telecommunications industry. A January 2011 Federal Communications Commission ("FCC") report on telecom competition states that as of December 2009, competitive local exchange carriers provided service to 21 million access lines, or approximately 17 percent of the nation's 127 million end-user switched access lines. Wireless carriers are providing service to more than 300 million mobile telephone service subscriptions—more than local exchange carriers and competitive local exchange carriers combined. For the most part, local exchange competition has benefited rural local exchange carriers by enabling them to enter nearby towns and cities as competitive local exchange carriers, leveraging their existing infrastructure and reputation for providing high-quality, modern telecommunications service. Rural local exchange carriers enjoy an exemption from the Telecom Act requirement to provide competitors with access to their networks, absent a determination that it would be in the public interest to do so. Relatively few rural local exchange carriers have competitive local exchange carriers request access to their networks.

The national goal of universal service is accomplished through a support mechanism (the Universal Service Fund) that is required to be: (i) sufficient to ensure that rural customers receive reasonable rates and services compared with urban customers and (ii) portable; that is, available to all eligible providers. The Universal Service Fund provides support for rural local exchange carriers with costs significantly above the national average. In addition, implicit subsidies long contained in the access charges local telecommunications companies' levy on long-distance carriers have been reduced. As these access charges have been reduced, rural local exchange carriers have been made whole by cost recovery provided by the Universal Service Fund. The Universal Service Fund is an important revenue source for most rural local exchange carriers.

The nexus between competition and universal service is the issue of competitor eligibility for universal service funding—the "portability" feature of the Universal Service Fund. As noted above, few wireline competitors attempted to enter rural markets. Numerous wireless carriers have extended their coverage areas into rural markets. By obtaining competitive eligible telecommunications carrier status from state and federal regulators (as provided for in the Telecom Act), these wireless carriers are able to receive universal service funds based on the incumbent local exchange carriers' costs (the "identical support" rule). This has led to growth in claims on the fund and great concern for its sustainability. The Universal Service Fund's current contribution base of interstate telecommunications revenue is shrinking as traditional long distance minutes-of-use decline due to wireless nationwide calling plans, e-mail and voice-over-Internet protocol substitution. Increased demand for funding from the Universal Service Fund has resulted in the rate assessed on all participants in the nationwide network (the "contribution factor") to increase to 14.9 percent of interstate and international long distance revenue for the second quarter of calendar year 2011, compared with approximately 10.2 percent five years ago.

Telecommunications Regulation

Rural telecommunications systems generally are regulated at the state and federal levels. Most state commissions regulate local service rates, intrastate access rates and telecommunications company borrowing. The FCC regulates interstate access rates and the issuance of licenses required to operate certain types of telecom operations. Some rural telecommunications systems have affiliated companies that are not regulated.

Deregulation has not had a significant effect on the wireline local exchange carrier business segment thus far. The FCC continues to regulate wireline telephony under Title II of the Act. Internet, video, wireless and competitive local exchange services are much less regulated. However, in pursuit of its net neutrality policy, the FCC in December 2010 promulgated new "open Internet" rules related to service transparency, blocking and discrimination, which are applicable to certain broadband Internet access services. It has also been considering other potential new regulations that would apply to broadband communications after having previously considered broadband Internet services to be information service exempt from Title II regulation. Most rural local exchange carriers are expanding their service offerings to customers in less regulated business segments. With few competitors in the most rural parts of their service areas, rural local exchange carriers generally have been successful in these growth and diversification efforts.

In May 2008, the FCC ordered that payments to competitive eligible telecommunications carriers be capped. Total support for a competitive eligible telecommunications carrier is capped at what it was eligible to receive as of March 2009. In January 2008, the FCC began proceedings on universal service funding. These related proceedings addressed creation of separate funds for incumbents and competitive eligible telecommunications carriers, and a more refined and explicit need-based methodology for determining the amount of Universal Service Fund support an eligible carrier would receive. The FCC also has opened proceedings on intercarrier compensation—the most important components of which are access fees local exchange carriers charge to interexchange carriers that originate or terminate long-distance traffic on local exchange carriers' networks. While the large local exchange carriers (most of which now own long-distance companies) would like to see these fees transition to zero, rural local exchange carriers depend heavily on access charges. The FCC's Notice of Proposed Rulemaking, which was released on February 9, 2011, states that the FCC's intent is to modernize the Universal Service Fund and intercarrier compensation rules including to provide support for broadband services utilizing recommendations from the aforementioned proceedings, and to establish policies that are "market-driven" with an implementation approach that is methodical and conducive to a non-disruptive transition. The FCC is now conducting a series of workshops on the proposed reforms that are designed to facilitate a process that is open to the public and incorporates input from principals throughout the industry. The rural telecommunications industry is actively participating in this process. At this stage, the outcome of the proposed rulemaking is unclear; however, the impending changes to the revenue mechanisms for rural telecommunications companies are not expected to result in our member rural local exchange carriers suffering revenue losses significant enough to cause material losses on our outstanding telecommunications loans.

Disaster Recovery

We have continued to use a comprehensive disaster recovery and business continuity plan since May of 2001. The plan includes a duplication of our production information systems at an offsite facility coupled with an extensive business recovery plan to use those remote systems. Our production data is replicated in real time to the recovery site 24 hours a day, seven days a week.

The plan also includes steps for each of our operating groups to conduct business with a view to minimizing disruption for our members and other parties with whom we do business. We conduct disaster recovery exercises twice a year that include both the information technology group and business areas. We contract with an external vendor for the facilities to house the backup systems that we own as well as office space and related office equipment. In fiscal year 2009, we moved our disaster recovery offsite facility from New Jersey to a location in western Virginia to allow for quicker access by employees to the site in the event of a disaster. We also implemented data duplication technology to provide backup to disks where backup data are also replicated to our disaster recovery site. In fiscal year 2010, we started a virtual recovery program to improve our remote access capabilities to address potential business disruptions such as weather-related events or pandemics.

Tax Status

In 1969, CFC obtained a ruling from the Internal Revenue Service recognizing CFC's exemption from the payment of federal income taxes under Section 501(c)(4) of the Internal Revenue Code. Such exempt status could be revoked as a result of changes in legislation or in administrative policy or as a result of changes in CFC's business.

In order for CFC to maintain its exemption under Section 501(c)(4) of the Internal Revenue Code, CFC must be "not organized for profit" and must be "operated exclusively for the promotion of social welfare" within the meaning of that section of the tax code. The Internal Revenue Service determined that CFC is an organization that is "operated exclusively for the promotion of social welfare" because the ultimate beneficiaries of its lending activities, like those of the RUS loan program, are the consumers of electricity produced by rural electric systems, the communities served by these systems and the nation as a whole.

As an organization described under Section 501(c)(4) of the Internal Revenue Code, no part of CFC's net earnings can inure to the benefit of any private shareholder or individual. This requirement is referred to as the private inurement prohibition and was added to Section 501(c)(4) of the Internal Revenue Code in 1996. A legislative exception allows organizations like CFC to continue to make allocations of net earnings to members in accordance with its cooperative status.

CFC believes its operations have not changed materially from those described to the Internal Revenue Service in its exemption filing. CFC reviews the impact on operations of any new activity or potential change in product offerings or business in general to determine whether such change in activity or operations would be inconsistent with its status as an organization described under Section 501(c)(4).

RTFC is a taxable cooperative under Subchapter T of the Internal Revenue Code and is not subject to income taxes on income from patronage sources that is allocated to its borrowers, as long as the allocation is properly noticed and at least 20 percent of the amount allocated is retired in cash prior to filing the applicable tax return. RTFC pays income tax based on its net income, excluding amounts allocated to its borrowers.

NCSC is a taxable cooperative that is subject to income tax annually based on its net income for the period. We believe that NCSC would qualify under Subchapter T of the Internal Revenue Code, and thus it would not be subject to income taxes on patronage-sourced net earnings allocated to its borrowers, as long as the allocation is properly noticed and at least 20 percent of the amount allocated is retired in cash prior to filing the applicable tax return. To date, NCSC's Board of Directors has not allocated its patronage-sourced net earnings to borrowers, thus NCSC pays income tax on the full amount of its net income.

Allocation and Retirement of Patronage Capital

District of Columbia cooperative law requires cooperatives to allocate net earnings to patrons, to a general reserve in an amount sufficient to maintain a balance of at least 50 percent of paid-up capital, and to a cooperative educational fund, as well as permits additional allocations to board-approved reserves. District of Columbia cooperative law also requires that a coooperative's net earnings be allocated to all patrons in proportion to their individual patronage and each patron's allocation be distributed to the patron unless the patron agrees that the cooperative may retain its share as additional capital.

CFC

Annually, CFC's Board of Directors allocates its net earnings to its patrons in the form of patronage capital, to a cooperative educational fund, to a general fund, if necessary, and to board-approved reserves. Net earnings are calculated by adjusting net income to exclude the non-cash effects of the accounting for derivative financial instruments and foreign currency translation. Negative net earnings, if any, are not allocated to members or to the reserves and do not affect amounts previously allocated as patronage capital or to the reserves. Net earnings may first be used to offset prior period losses, if any.

An allocation to the general fund is made, if necessary, to maintain the balance of the general fund at 50 percent of the membership fees collected. CFC's bylaws require the allocation to the cooperative educational fund to be at least 0.25 percent of its net earnings. Funds from the cooperative educational fund are disbursed annually to statewide cooperative organizations to fund the teaching of cooperative principles and for other cooperative education programs.

Currently, CFC has one additional board-approved reserve, the members' capital reserve. CFC's Board of Directors determines the amount of net earnings that is allocated to the members' capital reserve, if any. The members' capital reserve represents net earnings that CFC holds to increase equity retention. The net earnings held in the members' capital reserve have not been specifically allocated to members, but may be allocated to individual members in the future as patronage capital if authorized by CFC's Board of Directors.

All remaining net earnings are allocated to CFC's members in the form of patronage capital. The amount of net earnings allocated to each member is based on the members' patronage of CFC's lending programs during the year. No interest is earned by members on allocated patronage capital. There is no effect on CFC's total equity as a result of allocating net earnings to members in the form of patronage capital or to board-approved reserves. CFC's Board of Directors has voted annually to retire a portion of the patronage capital allocation. Upon retirement, patronage capital is paid out in cash to the members to whom it was allocated. CFC's total equity is reduced by the amount of patronage capital retired to its members and by amounts disbursed from board-approved reserves.

Pursuant to CFC's bylaws, CFC's Board of Directors shall determine the method, basis, priority and order of retirement of amounts allocated. The current policy of the CFC Board of Directors is to retire 50 percent of the prior fiscal year's allocated net earnings following the end of each fiscal year and to hold the remaining 50 percent for 25 years to fund operations. The amount and timing of future retirements remains subject to annual approval by CFC's Board of Directors, and may be affected by CFC's financial condition and other factors. 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 cooperative law.

RTFC

In accordance with District of Columbia cooperative law and its bylaws and board policies, RTFC allocates its net earnings to its patrons, a cooperative educational fund and a general reserve, if necessary. Negative net earnings, if any, are not allocated to members or to the reserves and do not affect amounts previously allocated as patronage capital or to the reserves. Net earnings may first be used to offset prior period losses, if any.

Pursuant to RTFC's bylaws, RTFC's Board of Directors shall determine the method, basis, priority and order of retirement of amounts allocated. RTFC's bylaws require that it allocate at least 1 percent of net earnings to a cooperative educational fund. Funds from the cooperative educational fund are disbursed annually to fund the teaching of cooperative principles and for other cooperative education programs. An allocation to the general fund is made, if necessary, to maintain the balance of the general fund at 50 percent of the membership fees collected. The remainder is allocated to borrowers in proportion to their patronage. RTFC provides notice to its members of the amount allocated and retires 20 percent of the allocation for that year in cash prior to the filing of the applicable tax return. Any additional amounts are retired as determined by RTFC's Board of Directors with due regard for RTFC's financial condition. There is no effect on the balance of noncontrolling interest due to the allocation of net earnings to members or board-approved reserves. The retirement of amounts previously allocated to members or amounts disbursed from Board-approved reserves reduces the balance of noncontrolling interest.

NCSC

In accordance with District of Columbia cooperative law and its bylaws and board policies, NCSC allocates its net earnings to a cooperative educational fund, to a general fund, if necessary, and to board-approved reserves. Net earnings are calculated by adjusting net income to exclude the non-cash effects of the accounting for derivative financial instruments and foreign currency translation. Negative net earnings, if any, are not allocated to members or to the reserves and do not affect amounts previously allocated to the reserves. Net earnings may first be used to offset prior period losses, if any.

Pursuant to NCSC's bylaws, the NCSC's Board of Directors shall determine the method, basis, priority and order of amounts allocated and retired. An allocation to the general fund is made, if necessary, to maintain the balance of the general fund at 50 percent of the membership fees collected. NCSC's bylaws require the allocation to the cooperative educational fund to be at least 0.25 percent of its net earnings. Funds from the cooperative educational fund are disbursed annually to fund the teaching of cooperative principles and for other cooperative education programs. To date, NCSC has not allocated net earnings to members. NCSC's Board of Directors has retained prior net earnings as operating capital. The NCSC Board of Directors has the authority to determine if and when patronage-sourced net earnings will be allocated and retired. There is no effect on the balance of noncontrolling interest due to the allocation of net earnings to board-approved reserves. The amounts disbursed from board-approved reserves reduce the balance of noncontrolling interest.

Investment Policy

Surplus funds are invested based on policies adopted by our Board of Directors. Under present policy, surplus funds may be invested in direct obligations of, or guaranteed by, the United States or agencies thereof or other highly liquid investment- grade securities. Current investments may include highly rated securities such as commercial paper, obligations of foreign governments, Eurodollar deposits, bankers' acceptances, bank letters of credit, certificates of deposit or working capital acceptances. The policy also permits investments in certain types of repurchase agreements with highly rated financial institutions, whereby the assets consist of eligible securities of a type listed above set aside in a segregated account. In addition, this policy permits investments in the Federal Agricultural Mortgage

Corporation.

Employees

At May 31, 2011, we had 219 employees, including financial and legal personnel, management specialists, credit analysts, accountants and support staff. We believe that our relations with our employees are good.

Item 1A. Risk Factors

Our financial condition, results of operations and liquidity are subject to various risks and uncertainties inherent in our business. The risks described below are the risks we consider to be material to our business. Other risks may prove to be material or important in the future. If any of the events or circumstances described in the following risks actually occur, our business, financial condition or results of operations could suffer adversely. You should consider all of the following risks together with all of the other information in this Annual Report on Form 10-K.

Our business depends on access to external financing.
We depend on access to the capital markets and other sources of financing, such as our revolving credit agreements, new investment from our members, private debt issuances through the Federal Agricultural Mortgage Corporation, and funding from the Federal Financing Bank through the Rural Economic Development Loan and Grant program, to fund new loan advances and refinance our long-term and short-term debt and, if necessary, to fulfill our obligations under our guarantee and repurchase agreements. We cannot assure that we will be able to raise capital in the future at all or on terms that are acceptable to us. Market disruptions, downgrades to our long-term debt ratings and/or short-term debt ratings, adverse changes in our business or performance, downturns in the rural electric or rural telephone industries and other events over which we have no control may deny or limit our access to the capital markets and/or subject us to higher costs for such funding. Our access to other sources of funding also could be limited by the same factors, by adverse changes in the business or performance of our members, by the banks committed to our revolving credit agreements or the Federal Agricultural Mortgage Corporation, or by changes in federal law or the REDLG program.

Our funding needs are determined primarily by scheduled long and short-term debt maturities and the amount of our loan advances to our borrowers relative to the scheduled amortization of loans previously made by us. If we are unable to timely issue debt into the capital markets or obtain funding from other sources, we may not have the funds to meet all of our obligations as they become due.

Fluctuating interest rates could adversely affect our income, margin and cash flow.
We are a cost-based lender that sets our interest rates on loans based on our cost of funding. We set our line of credit interest rate and long-term variable interest rate monthly based on the cost of our underlying funding. We do not match fund the majority of our long-term fixed-rate loans with a specific debt issuance at the time the loans are advanced. Instead, long-term fixed-rate loans are aggregated until the volume reaches a level that will allow an economically efficient issuance of long-term debt to fund long-term fixed-rate loans. As such, we are exposed to interest rate risk on our long-term fixed-rate loans during the period from which we have set a fixed rate on the loan until the time we obtain the long-term funding for the loan from the market. At May 31, 2011, fixed-rate loans funded with variable-rate debt totaled $1,262 million, or 6 percent of total assets and total assets excluding derivative assets.

A decrease in long-term fixed interest rates provided by other lenders could result in an increase in prepayments on long-term fixed-rate loans scheduled to reprice. Borrowers are able to prepay the long-term fixed-rate loan without a make-whole fee at the time the fixed-rate term expires and the loan reprices. An increase in loan prepayments due to repricings could cause a decrease to earnings for the period of time it takes to use cash from such prepayments to repay maturing debt or make new loan advances. At May 31, 2011, $1,796 million of fixed-rate loans have a fixed-rate term scheduled to reprice during the next 12 months.

In addition, the calculated impairment on certain restructured loans will increase as our long-term variable and line of credit interest rates increase. Based on the current balance of impaired loans at May 31, 2011, an increase or decrease of 25 basis points to our 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 of the impaired borrower.

Competition from other lenders could impair our financial results.
We compete with other lenders for the portion of the rural utility loan demand for which RUS will not lend and for loans to members who have elected not to borrow from RUS. The primary competition for the non-RUS loan volume is from CoBank, ACB, a federally chartered instrumentality of the United States that is a member of the Farm Credit System. As a government-sponsored enterprise, CoBank, ACB, has the benefit of an implied government guarantee. Competition may limit our ability to raise rates to cover all increases in costs and may negatively impact net income. Raising our interest rates to cover increased costs could cause a reduction in new lending business.

Our elected directors also serve as officers or directors of certain of our individual member cooperatives, which may result in a potential conflict of interest with respect to loans, guarantees and extensions of credit that we may make to or on behalf of such member cooperatives.

In accordance with our charter documents and the purpose for which we were formed, we lend only to our members and associates. CFC's directors are elected or appointed from our membership, with 10 director positions filled by directors of members, 10 director positions filled by general managers or chief executive officers of members, two positions appointed by the National Rural Electric Cooperative Association and one at-large position that must, among other things, be a director, financial officer, general manager or chief executive of one of our members. To address the conflict of interest inherent in our credit and lending activities with respect to any member that has one of its officers or directors sitting on CFC's Board of Directors, all loans, guarantees and other extensions of credit to such member are required to be approved by a majority of CFC's Board of Directors or a majority of the loan committee of CFC's Board of Directors, with the interested director being recused from both the discussions and the vote on the approval of the proposed loan, guarantee or extension of credit. Notwithstanding the foregoing, the Chief Executive Officer has the authority to approve emergency and certain other lines of credit. All such loan requests are required to go through the same underwriting process and review as other loan requests before being submitted to the Board of Directors or loan committee for approval. Unlike FDIC-insured banking institutions, we are not subject to federal or state regulation, examination or oversight with regard to our lending activity.

We are subject to credit risks related to collecting the amounts owed to us on our outstanding loans. Increased credit risk related to our loans or actual losses that exceed our allowance for loan losses could impair our financial results. Our allowance for loan losses is established through a provision charged to expense that represents management's best estimate of probable losses that have been incurred within the existing loan portfolio. The level of the allowance reflects management's continuing evaluation of credit risk related to industry concentrations; economic conditions; specific credit risks; loan loss experience; current loan portfolio quality; present economic, political and regulatory conditions; and unidentified losses and risks inherent in the current loan portfolio. The determination of the appropriate level of the allowance for loan losses involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in the allowance for loan losses. In addition, if actual losses incurred exceed current estimates of probable losses included in the allowance for loan losses, we will need additional provisions to increase the allowance for loan losses. Any material increases in the allowance for loan losses will result in a decrease in net income, and may have a material adverse effect on our financial results.

We have been and may in the future be in litigation with borrowers related to enforcement or collection actions pursuant to loan documents. In such cases, the borrower or others may assert counterclaims against us or initiate actions against us related to the loan documents. Unfavorable rulings in these cases that result in loan losses that exceed the related allowance could have a material adverse effect on our financial results.

We own and operate assets and entities obtained through foreclosure and are subject to the same performance and financial risks as any other owner or operator of similar assets or businesses.
As the owner and operator of assets and entities obtained through foreclosure, we are subject to the same performance and financial risks as any other owner or operator of similar assets or entities. In particular, there is the risk that the value of the foreclosed assets or entities will deteriorate, negatively affecting our results of operations. We assess our portfolio of foreclosed assets for impairment periodically as required under generally accepted accounting principles in the United States. Impairment charges, if required, represent a reduction to earnings in the period of the charge. There may be substantial judgment used in the determination of whether such assets are impaired and in the calculation of the amount of the impairment. In addition, when foreclosed assets are sold to a third party, the sale price we receive may be below the amount previously recorded in our financial statements, which will result in a loss being recorded in the period of the sale.

The non-performance of counterparties to our derivative agreements could impair our financial results.
We use interest rate swaps to manage our interest rate risk. There is a risk that the counterparties to these agreements will not perform as agreed, which could adversely affect our results of operations. The non-performance of a counterparty on an agreement would result in the derivative no longer being an effective risk management tool, which could negatively affect our overall interest rate risk position. In addition, if a counterparty fails to perform on our derivative obligation, we could incur a financial loss to replace the derivative with another counterparty and/or a loss through the failure of the counterparty to pay us amounts owed.

At May 31, 2011, we were a party to derivative instruments with notional amounts totaling $10,940 million. At May 31, 2011, the highest concentration of total notional exposure to any one counterparty was 13 percent of total derivative instruments. Based on the fair market value of our derivative instruments at May 31, 2011, there were five counterparties that would be required to make payments to us totaling $62 million if all of our derivative instruments were terminated on that date. The largest amount owed to us by a single counterparty was $28 million, or 46 percent of the total payments owed to us at May 31, 2011.

A reduction in the credit ratings for our debt could adversely affect our liquidity and/or cost of debt.
Nationally recognized statistical rating organizations play an important role in determining, by means of the ratings they assign to issuers and their debt, the availability and cost of debt funding. We currently contract with two nationally recognized statistical rating organizations to receive ratings for our secured and unsecured debt and our commercial paper. Our credit ratings are important to our liquidity. In order to access the commercial paper markets at current levels, we believe that we need to maintain our current ratings for commercial paper of P1 from Moody’s Investors Service and A1 from Standard & Poor’s Corporation. Actions by governmental entities or others, additional losses from impaired loans and other factors could adversely affect the credit ratings on our debt. A reduction in our credit ratings could adversely affect our liquidity,

competitive position, or the supply or cost of debt financing available to us. A significant increase in our interest expense could cause us to sustain losses or impair our liquidity by requiring us to seek other sources of financing, which may be difficult to obtain.

A decline in our credit rating could trigger payments under our derivative agreements, which could impair our financial results.
We have certain interest rate swaps that contain credit risk-related contingent features referred to as rating triggers. Under certain 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. These rating triggers are based on our senior unsecured credit rating from Moody's Investors Service and Standard & Poor's Corporation. Based on the fair market value of our interest rate exchange agreements subject to rating triggers at May 31, 2011, we may be required to make a payment of up to $114 million if our senior unsecured ratings from Moody's Investors Service falls to or below Baa1 or from Standard & Poor's Corporation falls to or below BBB+ and all agreements for which we owe amounts are terminated. In calculating the required payments, we only considered agreements that, when netted for each counterparty as allowed by the underlying master agreement, would require a payment upon termination. In the event that we are required to make a payment as a result of a rating trigger, it could have a material adverse impact on our financial results.

At May 31, 2011, our senior unsecured debt credit ratings from Moody's Investors Service and Standard & Poor's Corporation were A2 and A, respectively. While the rating triggers on our interest rate exchange agreements are not tied to the rating outlooks from Moody's Investors Service and Standard & Poor's Corporation, such rating outlooks may provide an indication of possible future movement in the ratings. At May 31, 2011, both Moody's Investors Service and Standard & Poor's Corporation had our ratings on stable outlook.

Our concentration of loans to borrowers within the rural electric industry could impair our revenue if that industry experiences economic difficulties.
At May 31, 2011, 93 percent of our total exposure was to rural electric cooperatives. Factors that have a negative impact on our member rural electric cooperatives' financial results could also impair their ability to make payments on our loans. If our members' financial results materially deteriorate, we could be required to increase our loan loss allowance through provisions for loan loss on our income statement that would reduce reported net income.

Advances in technology may change the way electricity is generated and transmitted or the way telecommunications services are provided to businesses and consumers prior to the maturity of our loans to rural electric and telecommunications systems.
To the extent that advances in technology make our electric system members' power supply, transmission and/or distribution facilities, or our telecommunications system members' networks or services obsolete prior to the maturity of our loans, there could be an adverse impact on the ability of our members to repay such loans. This could lead to an increase in non-performing or restructured loans and an adverse impact on our results of operations.

Loss of our tax-exempt status could increase our tax liability.
CFC has been recognized by the Internal Revenue Service as an organization for which income is exempt from federal income taxation under Section 501(c)(4) of the Internal Revenue Code (other than any net income from an unrelated trade or business). In order to maintain CFC's tax-exempt status, it must continue to operate exclusively for the promotion of social welfare by operating on a cooperative basis for the benefit of its members by providing them cost-based financial products and services consistent with sound financial management, and no part of CFC's net earnings may inure to the benefit of any private shareholder or individual other than the allocation or return of net earnings or capital to its members in accordance with CFC's current bylaws and incorporating statute.

If CFC were to lose its status as a 501(c)(4) organization, we believe that it would be subject to the tax rules generally applicable to cooperatives under Subchapter T of the Internal Revenue Code. As a Subchapter T cooperative, CFC would be allowed to allocate its patronage-sourced income to its members and take a deduction for the amount of such patronage dividends that are paid in cash or qualified written notices of allocation. However, CFC would be taxed as a regular corporation on any income in excess of allowed deductions, if any.

Our ability to comply with covenants related to our revolving credit agreements, debt indentures and debt agreements could affect our ability to retire patronage capital, may accelerate certain debt obligations and could affect our ability to obtain financing and maintain preferred rating levels on our debt.
We must maintain compliance with all covenants and conditions related to our revolving credit agreements and debt indentures.

We are required to maintain a minimum adjusted TIER for the six most recent fiscal quarters of 1.025, an adjusted leverage ratio of no more than 10-to-1 and we must maintain loans pledged as collateral for various debt issuances at or below 150 percent of the related secured debt outstanding as a condition to borrowing under our revolving credit agreements. Our revolving credit agreements also state that we must earn a minimum annual adjusted TIER of 1.05 in order to retire patronage capital to members. See Non-GAAP Financial Measures for further explanation and a reconciliation of our adjusted ratios.

If we are unable to borrow under the revolving credit agreements, our short-term debt ratings would most likely decline, and our ability to issue commercial paper could become significantly impaired. As a member-owned cooperative, all of our retained equity belongs to our members. As such, a restriction on the retirement of patronage capital in any year would result in a delay in the return of such amounts to the members until we earn an annual TIER of at least 1.05 and our board approves the retirement of the amounts allocated from the year in which retirement was restricted. A patronage capital retirement in any one year reduces the effective cost of borrowing for a member’s loan from CFC. Thus, if CFC does not retire patronage capital to its members, it results in a higher effective rate of borrowing from CFC for that year.

Pursuant to our collateral trust bond indentures, we are required (i) to maintain eligible collateral pledged at least equal to 100 percent of the principal amount of the bonds issued under the indenture, and (ii) to limit senior indebtedness to 20 times the sum of our members’ equity, subordinated deferrable debt and members’ subordinated certificates. Our medium-term note indentures also require us to comply with (ii) above.

If we are in default under our collateral trust bond or medium-term note indentures, the existing holders of our collateral trust bonds or medium-term notes have the right to accelerate the repayment of the full amount of the outstanding debt principal before the stated maturity of such debt. That acceleration of debt repayments poses a significant liquidity risk as we might not have enough cash or committed credit available to repay the debt. In addition, if we are not in compliance with the collateral trust bond and medium-term note covenants, we would be unable to issue new debt securities under such indentures. If we were unable to issue new collateral trust bonds and medium-term notes, our ability to fund new loan advances and refinance maturing debt would be impaired.

We are required to pledge eligible distribution system or power supply system loans as collateral equal to at least 100 percent of the outstanding balance of debt issued under a revolving note purchase agreement with the Federal Agricultural Mortgage Corporation. We are also required to maintain distribution and power supply loans as collateral on deposit equal to at least 100 percent of the outstanding balance of debt under the Guaranteed Underwriter program of the U.S. Department of Agriculture, which supports the Rural Economic Development Loan and Grant program. Collateral coverage under 100 percent for either of these debt programs constitutes an event of default, which if not cured within 30 days, could result in creditors accelerating the repayment of the outstanding debt principal before the stated maturity. This poses a liquidity risk of possibly not having enough cash or committed credit available to repay the debt. In addition, we would be unable to issue new debt securities under the applicable debt agreement, which could impair our ability to fund new loan advances and refinance maturing debt.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties

CFC leases approximately 107,228 square feet of office, meeting and storage space that serves as its headquarters in Fairfax County, Virginia. This lease is scheduled to expire on October 17, 2011 and will not be renewed.

CFC purchased 42 acres of land located in Loudoun County, Virginia in May 2008. In June 2010, CFC entered into a definitive agreement for construction of a new headquarters facility using 16 of the 42 acres of land we own. The excess land is available if we need to expand in the future. Our new headquarters facility is scheduled for completion in the third quarter of calendar year 2011. Our new headquarters facility will be approximately 120,000 square feet and will be constructed at a cost not expected to exceed $39.5 million. We do not expect the change from leasing to owning our headquarters building to have a material impact on our operating results because the annual cost of operating, maintaining and depreciating the new building is expected to be less than the annual cost of the current lease.

Item 3. Legal Proceedings.

From time to time, CFC is subject to certain legal proceedings and claims in the ordinary course of business, including litigation with borrowers related to enforcement or collection actions. In such cases, the borrower or others may assert counterclaims or initiate actions against us. Management presently believes that the ultimate outcome of these proceedings, individually and in the aggregate, will not materially harm our financial position, liquidity, or results of operations. CFC establishes reserves for specific legal matters when it determines that the likelihood of an unfavorable outcome is probable and the loss is reasonably estimable. Accordingly, no reserve has been taken with respect to any legal proceedings at this time. Legal proceedings are, however, subject to inherent uncertainties, and unfavorable rulings could occur that could have individually or in aggregate, a material adverse effect on our business, financial condition, or operating results. Related to the ICC bankruptcy proceedings described on page 32 in the Executive Summary section of Management's Discussion and Analysis under Transfer of Control of ICC Operating Entities, ICC’s former indirect majority shareholder and former chairman, 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 anticipates that it will continue to be engaged in defense of those assertions on many fronts, as well as pursuing claims of its own.

Item 4. [Removed and Reserved].

None.

PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Inapplicable.

Item 6. Selected Financial Data.

The following is a summary of selected financial data for the years ended and as of May 31:

(dollar amounts in thousands)					
For the year ended May 31:	2011	2010	2009	2008	2007
Interest income	$ 1,008,911}	$ 1,043,635}	$ 1,070,764	$ 1,051,393	$ 1,039,650
Net interest income	167,831}	131,524}	135,743	120,125	47,896
Derivative (losses) gains (1)	(30,236)	(20,608)	(47,028)	(71,710)	7,161
Foreign currency adjustments (2)	-}	-	-	-	(14,554)
Income (loss) prior to income taxes (3)	152,542}	110,251}	(78,871)	36,311	16,541
Net income (loss) (3)	151,215}	110,547}	(73,770)	39,646	14,145
Fixed-charge coverage ratio (TIER) (4)(5)	1.18}	1.12}	-	1.04	1.01
Adjusted TIER (6)	1.21}	1.12}	1.10	1.15	1.12
As of May 31:					
Loans to members	$ 19,330,797}	$ 19,342,704}	$20,192,309	$19,029,040	$18,131,873
Allowance for loan losses	(161,177)	(592,764)	(622,960)	(514,906)	(561,663)
Assets	20,561,622}	20,143,215}	20,982,705	19,379,381	18,575,181
Short-term debt	5,842,924}	4,606,361}	4,867,864	6,327,453	4,427,123
Long-term debt (7)	11,293,249}	12,054,497}	12,720,055	10,173,587	11,295,219
Subordinated deferrable debt (8)	186,440}	311,440}	311,440	311,440	311,440
Members’ subordinated certificates (9)	1,801,212}	1,810,715}	1,740,054	1,406,779	1,381,447
Members’ equity (10)	790,241}	669,355}	604,316	613,082	566,286
Total equity	687,309}	586,767}	519,100	680,212	732,030
Guarantees	1,104,988}	1,171,109}	1,275,455	1,037,140	1,074,374
Leverage ratio (5)	30.52}	35.33}	41.88	29.01	25.84
Adjusted leverage ratio (6)	6.48}	6.34}	7.06	7.48	6.82
Debt-to-equity ratio (5)	28.92}	33.33}	39.42	27.49	24.37
Adjusted debt-to-equity ratio (6)	6.09}	5.93}	6.59	7.04	6.39

(1) Amount represents changes in the fair value of derivative instruments (forward value) along with realized gains and losses from cash settlements. Derivative cash settlements represent the net settlements received/paid on interest rate and cross currency exchange agreements that do not qualify for hedge accounting. The derivative forward value represents the change in fair value on exchange agreements that do not qualify for hedge accounting, as well as

amortization related to the transition adjustment recorded as an other comprehensive loss on June 1, 2001.
(2) Foreign currency adjustments represent the change in value of foreign-denominated debt that is not related to an exchange agreement that qualifies for hedge accounting during the period and recorded in the statement of operations. The foreign-denominated debt is revalued at each reporting date based on the current exchange rate. If the current exchange rate is different than the exchange rate at the time of issuance, there will be a change in the value of the foreign-denominated debt. The adjustment to the debt is recorded in the foreign currency valuation account on the balance sheet. We enter into foreign currency exchange agreements at the time of each foreign-denominated debt issuance to lock in the exchange rate for all principal and interest payments required through maturity.
(3) Includes a one-time gain of $23 million from the proceeds of a settlement with CoBank, ACB, for the year ended May 31, 2010.
(4) For the years ended May 31, 2011, 2010 and 2009, the fixed-charge coverage ratio includes capitalized interest in total fixed charges, which is not included in our times interest earned ratio ("TIER") calculation. For the years ended prior to May 31, 2009, the fixed-charge coverage ratio is the same calculation as our TIER as we did not have any capitalized interest during those periods. For the year ended May 31, 2009, earnings were insufficient to cover fixed charges by $74 million.
(5) See Non-GAAP Financial Measures in Management's Discussion and Analysis for the GAAP calculations of these ratios.
(6) Adjusted ratios include non-GAAP adjustments that we make to financial measures in assessing our financial performance. See Non-GAAP Financial Measures in Management's Discussion and Analysis for further explanation of these calculations and a reconciliation of the adjustments.
(7) Excludes $2,523 million, $2,312 million, $2,580 million, $3,177 million and $1,368 million in long-term debt that comes due, matures and/or will be redeemed during fiscal years 2012, 2011, 2010, 2009 and 2008, respectively (see Note 5 to the consolidated financial statements).
(8) Excludes $175 million called in June 2007 reported in short-term debt at May 31, 2007.
(9) Excludes $12 million of members' subordinated certificates reported as short-term debt at May 31, 2011.
(10) Members' equity represents total equity excluding foreign currency adjustments, derivative forward value, accumulated other comprehensive income and noncontrolling interest. See the Financial Condition/Liabilities and Equity section in Management's Discussion and Analysis for further details of members' equity and a reconciliation to total equity.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

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

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

Executive Summary

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

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

Lending Activity

The balance of loans outstanding remained relatively stable during the year ended May 31, 2011. During the year there were increases in loans outstanding to CFC and NCSC borrowers totaling $627 million and $173 million, respectively, and a decrease of $813 million in RTFC loans outstanding. The loans outstanding to CFC and NCSC borrowers increased due to a total of $1,109 million of loan advances used to refinance the debt of other lenders. This increase in loans outstanding was partly offset by distribution and power supply loans sold to the Federal Agricultural Mortgage Corporation totaling $327 million, of which $164 million were advanced at the time of sale, and by $75 million of loans prepaid at their repricing date. RTFC loans as a percentage of our total loan portfolio decreased from 9 percent at May 31, 2010 to 4 percent at May 31, 2011 as a result of the $536 million reduction in non-performing loans to Innovative Communication Corporation ("ICC"), as described below, and the prepayment of $204 million of telecommunications loans related to the acquisition of one of our borrowers.

During the period June 1, 2010 through May 31, 2011, $1,699 million of long-term fixed-rate loans were scheduled to reprice. Of that total, $1,338 million selected a new long-term fixed rate; $260 million selected the long-term variable rate; $26 million selected a new rate offered by the Federal Agricultural Mortgage Corporation and were sold by CFC to the Federal Agricultural Mortgage Corporation with CFC continuing to service the loans sold; and $75 million were prepaid in full.

Transfer of Control of ICC Operating Entities

During fiscal year 2011, a wholly-owned subsidiary of CFC, Caribbean Asset Holdings (“CAH”), obtained control of 100 percent of the equity interests of ICC’s United States Virgin Island (“USVI”), British Virgin Island and St. Maarten operating entities. RTFC was the primary secured lender to ICC, a diversified telecommunications company headquartered in St. Croix, USVI. The transfer of control of these entities from ICC to CAH was completed in two phases and was the result of ICC bankruptcy proceedings. RTFC assigned to CFC its rights with respect to the entities transferred as partial repayment of its loan from CFC. As part of the transfer of control, we received entities with a fair value of $166 million and invested $88 million to pay down existing third party debt for a total investment of $254 million to foreclosed assets. Additionally, we recorded a $354 million charge-off of the ICC loan balance. See further discussion in Note 4, Foreclosed Assets, to the consolidated financial statements.

Funding Activity

During the year ended May 31, 2011, our funding needs were primarily related to the refinancing of maturing debt since there was little change in our overall funding requirements due to a flat loan portfolio. However, during fiscal year 2011, we refinanced higher-cost debt with lower-cost debt. A higher utilization of our commercial paper issuance capacity was a key factor in our efforts to reduce our overall effective interest rate on borrowed funds during fiscal year 2011 as commercial paper is our lowest-cost source of debt funding. Our average balance of commercial paper, bid notes and daily liquidity fund outstanding increased to $2,767 million, or 15 percent of total average debt volume, compared with 11 percent of total average debt volume for the year ended May 31, 2010. The higher average balance of commercial paper was offset by a lower average balance of medium-term notes, which decreased to 21 percent of total average debt volume for the year ended May 31, 2011 from 24 percent for the prior-year period. As a result, short-term debt as a percentage of total debt increased to 17 percent at May 31, 2011 compared with 12 percent at May 31, 2010.

During the year ended May 31, 2011, our funding requirements were driven mainly by $907 million of maturing collateral trust bonds, the early redemption of $125 million of subordinated deferrable debt and medium-term note maturities that exceeded new issuances by $575 million. To refinance these debt obligations, we primarily issued a combination of commercial paper and $950 million of new collateral trust bonds. See further discussion of the decrease in interest expense during fiscal year 2011 as a result of refinancing debt maturities with lower-cost debt in the Financial Results section below.

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 any time before October 15, 2013, with each advance having a final maturity not longer than 20 years from the advance date. In March 2011, we borrowed $150 million under this facility. On April 15, 2011, the President of the United States signed the Full-Year Continuing Appropriations Act for Fiscal Year 2011, which provided an additional $500 million under the Rural Economic Development Loan and Grant program. CFC has submitted an application to RUS for the $500 million, 20-year maturity RUS-guaranteed Federal Financing Bank loan authorized under this program. The amount approved for CFC by the federal government by its fiscal year ending September 30, 2011 could range between $0 and $500 million.

At May 31, 2011 and 2010, we had secured notes payable of $1,411 million and $1,587 million outstanding to the Federal Agricultural Mortgage Corporation under note purchase agreements totaling $3,900 million and $2,400 million, respectively. During fiscal year 2011, we entered into an agreement that increased the amount we can borrow under revolving note purchase agreements with the Federal Agricultural Mortgage Corporation by $1,500 million. Under the terms of our current note purchase agreement with the Federal Agricultural Mortgage Corporation, we can borrow up to $3,900 million, subject to market conditions for debt issued by the Federal Agricultural Mortgage Corporation, through January 11, 2016. At May 31, 2011 and through the filing date, we have $2,489 million available under this revolving note purchase agreement.

On March 21, 2011, we replaced the $967 million, five-year revolving credit agreement that terminated on March 22, 2011 with a new $1,125 million, three-year agreement that expires on March 21, 2014. As a result, the total committed credit available under our three current facilities is $3,545 million at May 31, 2011.

Financial Results
For the years ended May 31, 2011 and 2010, we reported net income of $151 million and $111 million, respectively, and TIER was 1.18 and 1.12, respectively. As previously mentioned, we use adjusted non-GAAP measures in our analysis to evaluate our performance and for covenant compliance.

We experienced an increase of $53 million, or 49 percent, to adjusted net interest income for the year ended May 31, 2011 compared with the prior-year period due to a decrease in interest expense that was greater than the decrease to interest income. The two primary factors driving the reduction to interest expense were the increased utilization of commercial paper in our overall funding mix and refinancing maturing term debt at lower interest rates. As a result, our adjusted interest expense fell from an average of $78 million per month for fiscal year 2010 to $71 million per month for fiscal year 2011. The average adjusted interest expense for the fourth quarter of fiscal year 2011 was even lower at $68 million per month.

The higher average balance of commercial paper outstanding and the decrease in the average balance of medium-term notes in our overall funding mix contributed to the overall decrease in interest expense during the year ended May 31, 2011 compared with the prior-year period. The average cost of commercial paper was 0.32 percent and 0.36 percent for the years ended May 31, 2011 and 2010, respectively, compared with the average cost of medium-term notes of 6.23 percent and 6.02 percent for the same periods, respectively. We also incurred additional interest expense during the prior-year period due to prefunding large debt maturities as we maintained commercial paper issuance capacity in reserve to address liquidity concerns in the market during that time.

The decrease in interest expense is also the result of refinancing term debt that matured or repriced during the year ended May 31, 2011 at lower interest rates. In November 2010, we refinanced $500 million of maturing 4.375 percent collateral trust bonds and the $125 million redemption of 6.75 percent subordinated deferrable debt with $650 million of new collateral trust bonds at an average interest rate of 1.54 percent. In January 2011, we repriced $750 million of long-term notes payable at an average effective rate of 1.73 percent, including gains from related treasury lock contracts where we qualified for hedge accounting treatment, compared with the effective interest rate of 5.20 percent prior to repricing. We estimate the transactions above resulted in combined savings of $22 million in interest expense during the year ended May 31, 2011, compared with the prior-year periods. On an annual basis, we estimate a $47 million reduction to interest expense as a result of these transactions.

For the year ended May 31, 2011, we recorded a recovery of loan losses totaling $83 million, an increase of $53 million over the recovery in the prior-year period. The recovery for the year ended May 31, 2011 was due to reductions in the allowance for loan losses held for the impaired and general loan portfolios of $47 million and $31 million, respectively, and a $5 million recovery of an amount previously written off for a telecommunications borrower in fiscal year 2008. The reduction to the loan loss allowance for impaired loans of $47 million was due to the change in fair value of collateral securing impaired loans of $26 million, as well as principal repayments on impaired loans that resulted in the remaining $21 million recovery from the loan loss reserve. The $31 million decrease in the reserve for the general portfolio was driven primarily by improvement in the borrowers' average internal risk rating, as well as updated credit default information and a lower weighted average maturity for the loans in the general portfolio, partly offset by an increase in the general loan balance outstanding.

The change in the items described above resulted in adjusted net income of $175 million for the year ended May 31, 2011 compared with $108 million for the same prior-year period. Adjusted TIER for the years ended May 31, 2011 and 2010 was 1.21 and 1.12, respectively. The adjusted TIER for the year ended May 31, 2010 excluding $23 million of settlement proceeds was 1.09.

At May 31, 2011, our debt-to-equity ratio was 28.92-to-1 compared with 33.33-to-1 at May 31, 2010. As mentioned previously, we use adjusted non-GAAP measures in our own analysis to evaluate our performance and for covenant compliance. Our adjusted debt-to-equity ratio increased to 6.09-to-1 at May 31, 2011 compared with 5.93-to-1 at May 31, 2010. This increase was caused by the increase in adjusted liabilities of $456 million.

Outlook for the Next 12 Months

We anticipate a decline in outstanding loan volume over the next 12 months. This projected decrease is due to a number of expectations including (i) the maturity of a large telecommunications loan, (ii) anticipated loan sales, (iii) the repayment of a power supply bridge loan with proceeds from the advance of funds from RUS and (iv) a lower level of long-term loan advances, as we do not expect that the increase in loan advances during the year ended May 31, 2011, driven by refinancing members' debt borrowed from other lenders, will continue in fiscal year 2012. As a result, scheduled long-term loan repayments are expected to be in excess of long-term loan advances. We recently expanded our loan product options by establishing two new programs to sell loans, in addition to the loan sale program we have with the Federal Agricultural Mortgage Corporation; therefore, we are projecting an increase in loan sales in fiscal year 2012. Management uses loan sales to manage credit concentrations, to manage the level of our debt-to-equity ratio and as an additional form of liquidity.

We estimate that our adjusted interest expense will continue to decline in fiscal year 2012, although at a slower pace than fiscal year 2011. Interest expense reductions are expected as a result of maintaining the current level of commercial paper in our funding mix, due to a full year of interest savings from refinancing debt at lower interest rates during fiscal year 2011 and due to an expected lower level of debt outstanding compared with the prior year. We do not anticipate a recovery of loan losses in fiscal year 2012 consistent with the $83 million recovery of loan losses in fiscal year 2011. As a result of anticipated reductions to loan volume, anticipation of a smaller recovery of loan losses and a slower pace of decline in adjusted interest expense, we believe our adjusted net income will be lower in fiscal year 2012 than in fiscal year 2011.

At May 31, 2011, we had long-term debt maturing in the next 12 months totaling $2,523 million. Almost 70 percent of this debt is scheduled to mature during the last quarter of fiscal year 2012, including a $1,500 million, 7.25 percent Series C medium-term note maturity scheduled for March 2012. On August 19, 2011, CFC redeemed $250 million of this amount at a premium. Both the premium and unamortized issuance costs of $9 million were recorded as a loss on extinguishment of debt during the first quarter of fiscal year 2012.

As a result, we anticipate that our funding needs will be limited until the second half of fiscal year 2012 when we expect to partly prefund the remaining March 2012 medium-term note maturity. Based on the expected reduction to outstanding loan balances, we do not anticipate that we will have to refinance the full amount of the remaining $1,250 million medium-term note maturity. We believe that our adjusted debt-to-equity ratio will fall below our target of 6.00-to-1 within the next 12 months as a result of the projected decrease in loan volume and an estimated slight increase to adjusted equity.

We believe there is sufficient liquidity from the combination of member loan repayments, 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 over the next 12 months.

Critical Accounting Policies and Estimates

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

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

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

Allowance for Loan Losses
GAAP requires loans receivable to be reported on the consolidated balance sheets at net realizable value. The net realizable value is the total principal amount of loans outstanding less an estimate of the probable losses inherent in the portfolio. We maintain an allowance for loan losses at a level estimated by management to provide for probable losses inherent in the loan portfolio. The allowance for loan losses is reported separately on the consolidated balance sheet, and the provision for loan losses is reported as a separate line item on the consolidated statement of operations. At May 31, 2011 and 2010, our loan loss allowance totaled $161 million and $593 million, 0.83 percent and 3.07 percent of total loans outstanding, respectively.

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

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

(1) the general portfolio which comprises loans that are performing according to the contractual agreements; and

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

General Portfolio

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

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

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

At May 31, 2011 and 2010, we had a total of $18,592 million and $18,037 million of loans, respectively, in the general portfolio. This total excludes $227 million and $237 million of loans at May 31, 2011 and 2010, respectively, that have a U.S. government guarantee of all principal and interest payments. We do not maintain a loan loss allowance on loans that are guaranteed by the U.S. government. At May 31, 2011 and 2010, we had a total loss allowance of $99 million and $125 million, respectively, for loans in the general portfolio representing coverage of 0.5 percent and 0.7 percent, respectively, of the total loans for the general portfolio.

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

- A single-obligor reserve to cover the additional risk associated with large loan exposures. This unallocated reserve is based on our internal risk ratings and applied to exposures above an established threshold. At May 31, 2011 and 2010, our single-obligor reserve was $25 million and $28 million, respectively.
- An economic and environmental reserve to cover factors we believe are currently affecting the financial results of borrowers but are not reflected in our internal risk rating process and, therefore, present an increased risk of losses incurred as of the balance sheet date. We use annual audited financial statements from our borrowers as part of our internal risk rating process. There could be a lag between the time various environmental and economic factors occur and the time when these factors are reflected in the annual audited financial statements of the borrower and, therefore, the internal risk rating we determine for the borrower. Our Corporate Credit Committee makes a quarterly determination of the percentage to apply to loans in the general portfolio as an additional reserve. This reserve component may be set at up to 10 percent of the amount of the calculated general loan loss allowance for each type of loan exposure. At May 31, 2011, the Corporate Credit Committee set the economic and environmental component of the unallocated reserve to be $0.5 million, representing 7 percent of the general reserve held for telecommunications loans compared with $3 million at May 31, 2010 representing 2 percent of the general reserve held for CFC and NCSC loans and 7 percent of the general reserve held for RTFC loans. At May 31, 2010, the Corporate Credit Committee took into consideration the effect on our borrowers from (i) the economic downturn, (ii) the increase in the unemployment rate, (iii) the decline in the housing market that led to a significant increase in foreclosures and (iv) specifically for telecommunications borrowers, reduced discretionary spending for telecommunications services, increased competition from wireless providers and continued loss of access lines among rural local exchange carriers. At May 31, 2011, the Corporate Credit Committee concluded that these factors continued to affect RTFC borrowers, but that CFC and NCSC borrowers were not significantly affected by the economic downturn and maintained or improved financial ratios. As a result, the Corporate Credit Committee reduced the unallocated reserve for CFC and NCSC loans to zero.

Impaired Loans

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

- the review of the borrower's audited financial statements and interim financial statements if available,
- the borrower's payment history,
- communication with the borrower,

- economic conditions in the borrower's service territory,
- pending legal action involving the borrower,
- restructure agreements between us and the borrower and
- estimates of the value of the borrower's assets that have been pledged as collateral to secure our loans.

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

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

At May 31, 2011 and 2010, respectively, there was a total specific loan loss allowance balance of $37 million and $437 million for impaired loans totaling $506 million and $1,064 million, representing 7 percent and 41 percent of total impaired loans. The $37 million and $437 million specific loan loss allowance balance represented 23 percent and 74 percent of the total loan loss allowance at May 31, 2011 and 2010, respectively. For certain impaired loans at May 31, 2011 and 2010, the effective interest rate at the time of impairment included a variable-rate component. As a result, the calculated impairment for these loans increases or decreases with changes in short-term and long-term variable interest rates. Based on the current balance of impaired loans at May 31, 2011, a 25 basis point increase or decrease to our variable interest rates would result in an increase or decrease, respectively, of approximately $9 million to the calculated impairment irrespective of a change in the credit fundamentals of the impaired borrower.

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

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

Fair Value

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

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

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

In addition to the valuation associated with derivative financial instruments, we also present foreclosed assets at fair value when initially recorded on the balance sheet. Subsequently, foreclosed assets are periodically reviewed for impairment. Our foreclosed assets do not meet the criteria to be classified as held for sale. If an impairment loss is recognized on our foreclosed assets, the adjusted carrying amount of the foreclosed assets becomes the new cost basis. Restoration of any recognized impairment loss is prohibited under GAAP, even when the fair value of the foreclosed assets increases subsequent to our recognition of impairment.

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

Results of Operations

The following table presents the results of operations for the years ended May 31, 2011, 2010 and 2009.

	For the years ended May 31,			Change from previous year	
(dollar amounts in thousands)	2011	2010	2009	2011 vs. 2010	2010 vs. 2009
Interest income	$ 1,008,911}	$ 1,043,635	$ 1,070,764	$ (34,724)	$ (27,129)
Interest expense	(841,080)	(912,111)	(935,021)	71,031}	22,910
Net interest income	167,831}	131,524	135,743	36,307}	(4,219)
Recovery of (provision for) loan losses	83,010}	30,415	(113,699)	52,595}	144,114
Net interest income after recovery of (provision for) loan losses	250,841}	161,939	22,044	88,902}	139,895
Non-interest income:					
Fee and other income	23,646}	17,711	13,163	5,935}	4,548
Settlement income	-}	22,953	-	(22,953)	22,953
Derivative losses	(30,236)	(20,608)	(47,028)	(9,628)	26,420
Results of operations from foreclosed assets	(12,028)	1,122	3,774	(13,150)	(2,652)
Total non-interest income	(18,618)	21,178}	(30,091)	(39,796)	51,269
Non-interest expense:					
	(42,856)	(39,113)	(36,865)	(3,743)	(2,248)

Salaries and employee benefits					
Other general and administrative expenses	(28,591)	(31,839)	(23,977)	3,248}	(7,862)
Recovery of (provision for) guarantee liability	673}	5,281	(1,615)	(4,608)	6,896
Fair value adjustment on foreclosed assets	(3,961)	(6,591)	(8,014)	2,630}	1,423
Loss on early extinguishment of debt	(3,928)	-}	-	(3,928)	-
Other	(1,018)	(604)	(353)	(414)	(251)
Total non-interest expense	(79,681)	(72,866)	(70,824)	(6,815)	(2,042)
Income (loss) prior to income taxes	152,542}	110,251}	(78,871)	42,291}	189,122
Income tax (expense) benefit	(1,327)	296	5,101	(1,623)	(4,805)
Net income (loss)	151,215}	110,547}	(73,770)	40,668}	184,317
Less: Net (income) loss attributable to noncontrolling interest	(1,789)	(235)	3,900	(1,554)	(4,135)
Net income (loss) attributable to CFC	$ 149,426}	$ 110,312}	$ (69,870)	$ 39,114}	$180,182
TIER (1)	1.18}	1.12}	-		
Adjusted TIER (2)	1.21}	1.12}	1.10		

(1) For the year ended May 31, 2009, we reported a net loss of $74 million and, therefore, the TIER calculation for that period results in a value below 1.00.
(2) Adjusted to exclude the effect of the derivative forward value from net income and to include all derivative cash settlements in the interest expense. The derivative forward value and derivative cash settlements are combined in the derivative losses line item in the chart above. See Non-GAAP Financial Measures for further explanation and a reconciliation of these adjustments.

Interest Income
The following tables break out the average 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

(dollar amounts in thousands)	Average volume 2011	Average volume 2010	Average volume 2009	Interest income 2011	Interest income 2010	Interest income 2009	Average yield 2011	Average yield 2010	Average yield 2009
Long-term fixed-rate loans (1)	$ 16,297,697}	$ 15,456,301	$ 15,052,425	$ 904,464}	$ 897,648	$ 890,367	5.55 %	5.81 %	5.92 %
Long-term variable-rate loans (1)	914,979}	1,609,562	1,698,646	45,590}	75,330	89,455	4.98	4.68	5.27
Line of credit loans (1)	1,415,919}	1,652,154	1,895,563	44,346}	56,055	75,604	3.13	3.39	3.99
Restructured loans	487,570}	521,570	556,892	2,789}	3,188	3,520	0.57	0.61	0.63
Non-performing loans	242,890}	523,813	495,014	149}	-	-	0.06	-	-
Total	19,359,055}	19,763,400	19,698,540	997,338}	1,032,221	1,058,946	5.15	5.22	5.38
Investments (2)	326,774}	550,597	489,228	3,830}	5,245	5,683	1.17	0.95	1.16
Fee income (3)	-}	-	-	7,743}	6,169	6,135	-	-	-
Total	$ 19,685,829}	$ 20,313,997	$ 20,187,768	$ 1,008,911}	$ 1,043,635	$ 1,070,764	5.13	5.14	5.30

(1) Interest income on loans to members.
(2) Interest income on the investment of excess cash and equity securities.
(3) Primarily related to conversion fees that are deferred and recognized using the effective interest method over the remaining original loan interest rate pricing term, except for a small portion of the total fee charged to cover administrative costs related to the conversion, which is recognized immediately.

Analysis of changes in interest income

	2011 vs. 2010			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 interest income:						

Long-term fixed-rate loans	$ 48,866}	$ (42,050)	$ 6,816}	$ 23,889}	$ (16,608)	$ 7,281}
Long-term variable-rate loans	(32,508)	2,768}	(29,740)	(4,692)	(9,433)	(14,125)
Line of credit loans	(8,015)	(3,694)	(11,709)	(9,708)	(9,841)	(19,549)
Restructured loans	(208)	(191)	(399)	(223)	(109)	(332)
Non-performing loans	-}	149}	149}	-}	-}	-}
Total interest income on loans	8,135}	(43,018)	(34,883)	9,266}	(35,991)	(26,725)
Investments	(2,132)	717}	(1,415)	713}	(1,151)	(438)
Fee income	-}	1,574}	1,574}	-}	34}	34}
Total interest income	$ 6,003}	$ (40,727)	$ (34,724)	$ 9,979}	$ (37,108)	$ (27,129)

(1) Calculated using the following formula: (current period average balance – prior-year period average balance) x prior-year period average rate.
(2) Calculated using the following formula: (current period average rate – prior-year period average rate) x current period average balance.
(3) The net change attributable to the combined impact of volume and rate has been allocated to each in proportion to the absolute dollar amounts of change.

During the year ended May 31, 2011, interest income decreased 3 percent compared with the prior-year period due to the 7 basis point decrease in the average yield on loans. We experienced a decrease in interest income during the year ended May 31, 2011 due to an overall decline to the interest rates offered on new long-term fixed-rate loan advances that was partly offset by an increase in interest income due to a higher percentage of long-term fixed-rate loans in the loan portfolio. The average loan balance for the year ended May 31, 2011 remained relatively stable compared with the prior-year period excluding the reduction related to non-accrual loans to ICC. The balance of loans outstanding decreased by $536 million during the year ended May 31, 2011, due to the completion of the transfer of control of ICC's operating entities to CAH in October 2010 and March 2011. Additional decreases in loan volume due to the sale of loans to the Federal Agricultural Mortgage Corporation and the prepayment of telecommunications loans during the year ended May 31, 2011 were offset by the increase in average loan volume due to loan advances to CFC and NCSC borrowers to refinance their debt borrowed from other lenders. During the year ended May 31, 2010, interest income decreased 3 percent compared with the prior-year period primarily due to the overall lower interest rate environment and pressure from competition resulting in a 16 basis point decline in the average yield on loans. See Financial Condition—Loan and Guarantee Portfolio Assessment for further explanation of the changes in loans outstanding.

The average long-term fixed interest rates we offered on electric loans for the years ended May 31, 2011 and 2010 decreased 63 basis points and 74 basis points, respectively, compared with the prior-year periods. 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 increased. During fiscal years 2011 and 2010, corporate spreads tightened, thus allowing us to lower long-term fixed rates we offer on our new loans.

The decrease in interest income due to lower interest rates was partly offset by the increase in interest income due to a higher average volume of long-term fixed-rate loans in the loan portfolio during the year ended May 31, 2011. The average volume of long-term fixed-rate loans increased to 84 percent of the total loan portfolio for the year ended May 31, 2011 from 78 percent for the same prior-year period. During the year ended May 31, 2011, long-term fixed-rate loans had an average yield of 5.55 percent compared with 4.98 percent and 3.13 percent for long-term variable and line of credit loans, respectively.

At May 31, 2011 and 2010, approximately 52 percent and 48 percent, respectively, 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 competition for the line of credit loan business. Of the line of credit loans priced lower than our standard rates at May 31, 2011 and 2010, 37 percent and 32 percent, respectively, were made as part of loan syndications where the pricing was agreed upon by all of the participating banks and was based on current market conditions.

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)	2011	2010	2009
Electric	$ 23,690}	$ 23,822	$ 26,421
Telecommunications	7,404}	29,028	29,817
Total	$ 31,094}	$ 52,850	$ 56,238

The decrease in interest foregone for telecommunications loans on non-accrual status was due to the reduction of non-accrual loans to ICC. Loans remaining on non-accrual status relate primarily to restructured loans to a large electric distribution cooperative that provides retail electric service to residential and business customers. While the loans to this borrower were on non-accrual status, the borrower was current with respect to all payments required under the restructured loan agreement. The decrease to interest income from holding this borrower’s loans on non-accrual status is largely offset by the reduction to the calculated impairment due to applying all payments received against the principal balance. The reduction to the calculated impairment results in the recognition of income from the recovery from the loan loss allowance. As a result, there is a limited effect on the overall financial statements from these non-accrual loans. During the year ended May 31, 2011, this borrower made scheduled payments of $28 million, all of which were applied as a reduction to the loan principal balance that resulted in a reduction of $21 million to the calculated impairment. The calculated impairment is based on the net present value of the expected future cash flow associated with the loan. As required by GAAP, credit risk related to the collection of future cash flows is taken into consideration in estimating the future cash flows associated with the loans to this borrower.

Interest Expense
The following tables break out the average cost of debt and the change to interest expense due to changes in average debt volume versus changes to interest rates summarized by debt type. We do not fund each individual loan with

specific debt. Rather, we attempt to minimize 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. Additionally, the tables present adjusted interest expense, which includes all derivative cash settlements in interest expense. See Non-GAAP Financial Measures for further explanation of the adjustment we make in our financial analysis to include all derivative cash settlements in interest expense.

Average balances and interest rates – Liabilities

	Average volume			Interest expense			Average cost		
(dollar amounts in thousands)	2011	2010	2009	2011	2010	2009	2011	2010	2009
Commercial paper and bank bid notes (1) (2)	$ 2,767,493}	$ 2,099,916	$ 3,188,189	$ (8,886)	$ (7,489)	$ (58,688)	(0.32)%	(0.36)%	(1.84)%
Medium-term notes (1)	3,877,036}	4,632,884	5,278,445	(241,545)	(278,972)	(326,313)	(6.23)	(6.02)	(6.18)
Collateral trust bonds (1)	5,251,158}	5,471,615	5,232,731	(306,332)	(320,059)	(290,152)	(5.83)	(5.85)	(5.54)
Subordinated deferrable debt (1)	211,428}	301,914	294,592	(13,358)	(19,663)	(19,663)	(6.32)	(6.51)	(6.67)
Subordinated certificates (1)	1,783,091}	1,750,077	1,428,083	(82,057)	(79,391)	(55,330)	(4.60)	(4.54)	(3.87)
Long-term notes payable (1)	4,654,860}	4,656,934	3,595,048	(167,700)	(184,958)	(164,306)	(3.60)	(3.97)	(4.57)
Total	18,545,066}	18,913,340	19,017,088	(819,878)	(890,532)	(914,452)	(4.42)	(4.71)	(4.81)
Debt issuance costs (3)	-}	-	-	(10,358)	(10,927)	(10,158)	-}	-}	-
Fee expense (4)	-}	-	-	(10,844)	(10,652)	(10,411)	-}	-}	-
Total	$ 18,545,066}	$ 18,913,340	$ 19,017,088	$ (841,080)	$ (912,111)	$ (935,021)	(4.54)	(4.82)	(4.92)
Derivative cash settlements (5)	$ 11,152,698}	$ 11,397,281	$ 12,764,394	$ (6,848)	$ (23,304)	$ 112,989	(0.06)%	(0.20)%	0.89}%
Adjusted interest expense (6)	18,545,066}	18,913,340	19,017,088	(847,928)	(935,415)	(822,032)	(4.57)	(4.95)	(4.32)

(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

	2011 vs. 2010			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 interest expense:						
Commercial paper and bank bid notes	$ (2,381)	$ 984}	$ (1,397)	$ 20,033}	$ 31,166}	$ 51,199}
Medium-term notes	45,514}	(8,087)	37,427}	39,909}	7,432}	47,341}
Collateral trust bonds	12,896}	831}	13,727}	(13,246)	(16,661)	(29,907)
Subordinated deferrable debt	5,893}	412}	6,305}	(489)	489}	-}
Subordinated certificates	(1,498)	(1,168)	(2,666)	(12,475)	(11,586)	(24,061)
Long-term notes payable	82}	17,176}	17,258}	(48,533)	27,881}	(20,652)
Total interest expense on debt (4)	60,506}	10,148}	70,654}	(14,801)	38,721}	23,920}
Debt issuance costs	-}	569}	569}	-	(769)	(769)
Fee expense	-}	(192)	(192)	-	(241)	(241)
Total interest expense (4)	$ 60,506}	$ 10,525}	$ 71,031}	$ (14,801)	$ 37,711}	$ 22,910}
Derivative cash settlements (5)	$ 500}	$ 15,956}	$ 16,456}	$ (12,102)	$(124,191)	$(136,293)
Adjusted interest expense (6)	18,214}	69,273}	87,487}	4,485	(117,868)	(113,383)

(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) Changes due to average volume and average rate represent a calculated amount and are not intended to sum.
(5) 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.
(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.

During the year ended May 31, 2011, interest expense decreased 8 percent compared with the same prior-year period primarily due to the 28 basis point reduction in the total cost of debt. The lower cost of debt was mostly the result of refinancing maturing term debt with a combination of commercial paper and term debt at lower interest rates. During fiscal year 2011, we increased the utilization of commercial paper in our funding mix. The increase in commercial paper to 15 percent of the total average debt outstanding for fiscal year 2011 from 11 percent for the prior-year period was offset by the decrease in medium-term notes to 21 percent of the total average debt outstanding from 24 percent for the prior-year period.

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At an average cost of 0.32 percent and 0.36 percent for the years ended May 31, 2011 and 2010, commercial paper is our lowest-cost source of debt funding and significantly lower in average cost compared with medium-term notes of 6.23 percent and 6.02 percent for the same periods, respectively. A decrease to our cost of debt also resulted from our issuance of collateral trust bonds in November 2010 at an average interest rate of 1.54 percent in order to refinance maturing collateral trust bonds with a fixed rate of 4.375 percent and redeem subordinated deferrable debt with a fixed rate of 6.75 percent.

We lowered our average cost for long-term notes payable by 37 basis points during the year ended May 31, 2011 compared with the prior-year period. In January 2011, we repriced $750 million of long-term notes payable to the Federal Financing Bank at an average effective rate of 1.73 percent compared with an effective rate of 5.20 percent prior to repricing. In addition, we issued notes totaling $400 million to the Federal Agricultural Mortgage Corporation in September 2010 and October 2010, at rates ranging from 0.62 percent to 0.67 percent. These notes matured during the third quarter of fiscal year 2011.

During the year ended May 31, 2010, interest expense decreased 2 percent compared with the same prior-year period primarily due to the 10 basis point reduction in the cost of debt resulting from the lower overall interest rate environment. The decrease in the average cost of debt was driven largely by the decrease in interest rates for commercial paper and long-term notes payable to the Federal Agricultural Finance Corporation. This decrease was partially offset by maintaining a lower balance of commercial paper in our overall funding mix and issuing more term debt, including collateral trust bonds, member capital securities and notes payable to the Federal Agricultural Finance Corporation.

The adjusted interest expense, which includes all derivative cash settlements, was $848 million for the year ended May 31, 2011, compared with $935 million and $822 million for the years ended May 31, 2010 and 2009, respectively. The adjusted interest expense was lower during the year ended May 31, 2011 due to the lower interest expense noted above and the decrease in the derivative cash settlements expense discussed further below. The adjusted interest expense was higher during the year ended May 31, 2010 as compared with the same prior-year period primarily due to cash settlements income resulting from terminated interest rate swaps during fiscal year 2009 as 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 years ended May 31,					
	2011	2010	2009	2011	2010	2009
(dollar amounts in thousands)	Interest income (expense)			Average yield (cost)		
Total interest income	$ 1,008,911}	$ 1,043,635	$ 1,070,764}	5.13}%	5.14}%	5.30}%
Total interest expense	(841,080)	(912,111)	(935,021)	(4.54)	(4.82)	(4.92)
Net interest income/Net yield	$ 167,831}	$ 131,524	$ 135,743}	0.59}%	0.32}%	0.38}%
Derivative cash settlements	(6,848)	(23,304)	112,989}	(0.06)	(0.20)	0.89}

Adjusted net interest income/Adjusted net yield (1)	160,983}	108,220	248,732}	0.55}	0.19}	0.98}

(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

	2011 vs. 2010			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	$ 66,509}	$(30,202)	$ 36,307}	$(4,822)	$ 603}	$ (4,219)
Increase (decrease) in adjusted net interest income	24,217}	28,546}	52,763}	14,464}	(154,976)	(140,512)

(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 increase of 28 percent to net interest income for the year ended May 31, 2011 compared with the prior-year period was primarily due to the reduction to interest expense, partially offset by the decrease in interest income as explained previously. Net interest income decreased 3 percent during the year ended May 31, 2010 compared with the prior-year period as the decline in the average yield of the loan portfolio was only partially offset by the decrease in the overall cost of debt. During fiscal year 2011, we maximized commercial paper in our funding mix while in fiscal year 2010 we issued more term debt to mitigate liquidity risks during that time.

Adjusted net interest income, which includes all derivative cash settlements, for the year ended May 31, 2011 was $161 million, compared with $108 million and $249 million for the years ended May 31, 2010 and 2009, respectively. Adjusted net interest income increased during fiscal year 2011 compared with the prior-year period primarily due to reductions to interest expense and lower cash settlements expense, partially offset by the decrease in interest income as explained previously. Adjusted net interest income decreased during fiscal year 2010 compared with the prior-year period primarily due to the cash settlement income received in fiscal year 2009 resulting from terminated interest rate swaps as discussed 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 determining our adjusted interest expense which, in turn, affects adjusted net interest income.

Recovery of (Provision for) Loan Losses

The loan loss recovery of $83 million was due to reductions in the allowance for loan losses held for the impaired and general loan portfolios of $47 million and $31 million, respectively, and a $5 million recovery of a charge-off recorded for a telecommunications borrower in fiscal year 2008. The reduction to the loan loss allowance for impaired loans of $47 million was due to the change in fair value of collateral securing impaired loans of $26 million, as well as principal repayments on impaired loans that resulted in the remaining $21 million recovery from the loan loss reserve. The $31 million decrease in the reserve for the general portfolio was driven primarily by improvement in the borrowers’ average internal risk rating, as well as updated credit default information and a lower weighted average maturity for the loans in the general portfolio, partly offset by an increase in the general loan balance outstanding. Additionally, there was a reduction to the required loan loss allowance for large loan exposures that meet the exposure threshold and improvement to the estimated requirement for economic and environmental factors not yet reflected in the financial results of our borrowers. The recovery of loan losses of $30 million for the year ended May 31, 2010 was primarily due to decrease of $48 million to the reserves for our general loan portfolio, partially offset by a $23 million increase to the reserve for impaired borrowers.

Non-interest Income

Non-interest income decreased by $40 million for the year ended May 31, 2011 compared with the prior-year period primarily due to the $23 million of settlement income recognized during the prior-year period, the $12 million net loss for entities previously operated by ICC included in the results of operations from foreclosed assets and the $10 million increase in derivative losses, partially offset by the $6 million increase in fee income. The settlement income was a one-time gain, net of legal and other related expenses, from CoBank, ACB, a government-sponsored enterprise that lends to agribusinesses and rural utilities throughout the United States. On February 25, 2010, CoBank, ACB, agreed to a settlement related to our discovery that, for a period of years, CoBank, ACB, employees improperly accessed confidential and proprietary information from our password-protected member website. During the year ended May 31, 2011, the results of operations from foreclosed assets includes a net loss of $12 million representing the ongoing results of operations for these entities since the date of transfer. The increase to fee income during the year ended May 31, 2011 was the result of a $6 million prepayment fee related to telecommunications loans. Non-interest income increased by $51 million for the year ended May 31, 2010 compared with the prior-year period primarily due to the $23 million of settlement income during the year ended May 31, 2010 described above and the decrease of $26 million to derivative losses for the year ended May 31, 2010 compared with the same prior-year period.

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

(dollar amounts in thousands)	2011	2010	2009
Derivative cash settlements	$ (6,848)	$ (23,304)	$ 112,989
Derivative forward value	(23,388)	2,696	(160,017)
Derivative losses	$ (30,236)	$ (20,608)	$ (47,028)

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We currently use two types of interest rate exchange agreements: (i) we pay a fixed rate and receive a variable rate and (ii) we pay a variable rate and receive a fixed rate. The following chart provides a breakout of the average notional amount outstanding by type of interest rate exchange agreement and the weighted average interest rate paid and received for cash settlements during the year ended May 31:

	2011			2010		
(dollar amounts in thousands)	Average Notional Balance	Weighted-Average Rate Paid	Weighted-Average Rate Received	Average Notional Balance	Weighted-Average Rate Paid	Weighted-Average Rate Received
Pay fixed-receive variable	$ 5,704,683	4.23%	0.33%	$ 5,875,213	4.65%	0.38%
Pay variable-receive fixed	5,448,015	1.22	5.23	5,522,068	1.23	5.33
Total	$11,152,698	2.76	2.73	$11,397,281	2.99	2.79

During the year ended May 31, 2011, the net weighted-average rate we paid on our interest rate swap agreements was 0.03 percent, excluding $3 million of cash settlement expense for early terminations of interest rate swaps related to prepaid telecommunications loans, representing a decrease from the net weighted-average rate paid of 0.20 percent for the same prior-year period. The primary reason for the decrease in the weighted average outflow was a reduction to the weighted-average rate we paid on our pay fixed-receive variable interest rate swaps. The lower payment for these swaps was driven by the maturity of pay fixed-receive variable swaps since May 31, 2010 that carried a higher fixed rate, as well as the addition of new pay fixed-receive variable swaps with a lower fixed rate compared with swaps in place during the prior-year period.

The derivative forward value represents the change in fair value of our interest rate swaps during the reporting period due to changes in the estimate of future interest rates over the remaining life of our derivative contracts. The derivative forward value recorded for the years ended May 31, 2011 and 2010 decreased by $26 million and increased by $163 million, respectively, compared with the prior-year periods. For the year ended May 31, 2011, the derivative forward value losses of $23 million were the result of the average decrease of 27 basis points to the estimated yield curve for our swaps based on market expectations of interest rates, which caused a decrease in the fair value of pay fixed-receive variable interest rate swaps, particularly those with long-dated maturities. The decrease in fair value of pay fixed-receive variable interest rate swaps during the year ended May 31, 2011 outweighed the increase in fair value for pay variable-receive fixed interest rate swaps as pay fixed-receive variable interest rate swaps represented 51 percent of our derivative contracts during the year ended May 31, 2011.

Cash settlements decreased during fiscal year 2010 compared with the prior-year period due to the $97 million of realized cash settlement income resulting from the termination of interest rate swaps in 2009. Additionally, the low interest rate environment, combined with the majority of our interest rate swaps being pay fixed-receive variable resulted in an average interest rate paid for cash settlements that was greater than the average interest rate received during fiscal year 2010.

Non-interest Expense

The $7 million increase to non-interest expense for the year ended May 31, 2011 compared with the prior-year period was due to the $4 million loss on early extinguishment of debt related to the redemption of $125 million of subordinated deferrable debt in fiscal year 2011, as well as higher salaries and employee benefits expense and a smaller recovery of guarantee liability. The $4 million increase to salaries and employee benefits expense was partially due to approximately $2 million of severance expense related to the early retirement of certain qualifying employees. The smaller recovery of guarantee liability was due to the smaller decrease in guarantees outstanding during the year ended May 31, 2011 compared with the prior-year period. The $3 million decrease in general administrative expenses during the year ended May 31, 2011 was largely driven by lower legal fees and other expenses as a result of the completion of the transfer of control of ICC's operating entities to CAH in October 2010 and March 2011. During fiscal year 2010, these legal costs were the primary reason for the $8 million increase in general and administrative expenses compared with the prior-year period. The $5 million recovery of guarantee liability during the year ended May 31, 2010 was largely due to the $104 million decrease to guarantees outstanding, as well as a lower weighted average maturity and improvement to the average internal risk rating compared with guarantees outstanding at May 31, 2009.

Non-interest expense for the years ended May 31, 2011, 2010 and 2009 also included fair value adjustments on foreclosed assets related to land development loans, the collateral for which includes developed lots and land, raw land and underground mineral rights. The fair value adjustments recorded during these periods was the result of reductions to the fair value of the collateral supporting the foreclosed assets driven by residential home market weakness, which caused lot sales to slow down, and the troubled commercial real estate market. Additionally, in fiscal year 2009 lower natural gas prices, which influence the fair value of the mineral rights, resulted in a decrease in the fair value of the underlying collateral.

Net Income (Loss)

The change in the items described above resulted in net income of $151 million and $111 million for the years ended May 31, 2011 and 2010, respectively. During the year ended May 31, 2009, we reported a net loss of $74 million. The adjusted net income, which excludes the effect of the derivative forward value, was $175 million, $108 million and $86 million for the years ended May 31, 2011, 2010 and 2009, respectively. See Non-GAAP Financial Measures for further explanation of the adjustments we make in our financial analysis to net income.

Net Income Attributable to the Noncontrolling Interest

Net income attributable to the noncontrolling interest represents 100 percent of the results of operations of RTFC and NCSC as the members of RTFC and NCSC own or control 100 percent of the interest in their respective companies. Noncontrolling interest for the year ended May 31, 2011 represents $0.4 million of net loss and $2.2 million of net income for RTFC and NCSC, respectively, compared with a net loss of $0.6 million and net income of $0.8 million for RTFC and NCSC, respectively, for the year ended May 31, 2010. Fluctuations in NCSC's net income and loss are primarily due to fluctuations in the fair value of its derivative instruments. Noncontrolling interest for the year ended May 31, 2009 represents an RTFC net loss of $1 million, and $3 million of NCSC's total net loss of $9 million for the year ended May 31, 2009. During the year ended May 31, 2009, NCSC's net loss exceeded its equity balance by $6 million primarily due to NCSC's $12 million in derivative forward value losses during the period. Under prior accounting standards, CFC was required to absorb the excess NCSC loss. Based on the provisions of new accounting standards applied prospectively starting June 1, 2009, the noncontrolling interest is required to absorb the full amount of its losses, even if the losses exceed its equity balance.

Ratio of Earnings to Fixed Charges

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

(dollar amounts in thousands)	2011	2010	2009
Income (loss) prior to cumulative effect of change in accounting principle	$ 151,215}	$ 110,547	$ (73,770)
Add: fixed charges	841,288}	912,227	935,194
Less: interest capitalized	(208)	(116)	(173)
Earnings available for fixed charges	$ 992,295}	$ 1,022,658	$ 861,251
Total fixed charges:			
Interest on all debt (including amortization of discount and issuance costs)	$ 841,080}	$ 912,111	$ 935,021
Interest capitalized	208}	116	173
Total fixed charges	$ 841,288}	$ 912,227	$ 935,194
Ratio of earnings to fixed charges (1)	1.18}	1.12	-

(1) For the year ended May 31, 2009, earnings were insufficient to cover fixed charges by $74 million.

Financial Condition

Loan and Guarantee Portfolio Assessment

Loan Programs

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

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

(dollar amounts in millions)	2011		2010		2009		2008		2007	
Loans by type (1):	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Long-term loans:										
Long-term fixed-rate loans	$ 16,405}	85%	$ 15,413	80%	$ 14,602	73%	$ 15,205	80%	$ 14,663	81%
Long-term variable-rate loans	1,278}	7	2,089	11	3,244	16	1,882	10	1,994	11
Loans guaranteed by RUS	227}	1	237	1	244	1	250	1	256	1
Total long-term loans	17,910}	93	17,739	92	18,090	90	17,337	91	16,913	93
Line of credit loans	1,415}	7	1,599	8	2,098	10	1,690	9	1,215	7
Total loans	$ 19,325}	100%	$ 19,338	100%	$ 20,188	100%	$ 19,027	100%	$ 18,128	100%
Loans by member class (1):										
CFC:										
Distribution	$ 13,760}	71%	$ 13,459	70%	$ 13,730	68%	$ 13,438	71%	$ 12,828	71%
Power supply	4,092}	21	3,770	19	4,268	21	3,339	17	2,858	16
Statewide and associate	90}	1	86	-	93	1	109	1	119	1
CFC total	17,942}	93	17,315	89	18,091	90	16,886	89	15,805	88
RTFC	859}	4	1,672	9	1,680	8	1,727	9	1,860	10
NCSC	524}	3	351	2	417	2	414	2	463	2
Total	$ 19,325}	100%	$ 19,338	100%	$ 20,188	100%	$ 19,027	100%	$ 18,128	100%

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

The balance of loans outstanding remained relatively stable during the year ended May 31, 2011. During fiscal year 2011, there were increases in loans outstanding to CFC and NCSC borrowers totaling $627 million and $173 million, respectively, and a decrease of $813 million in RTFC loans outstanding. The loans outstanding to CFC and NCSC borrowers increased due to a total of $1,109 million of loan advances used to refinance the debt of other lenders. This increase in loans outstanding was offset by loan principal repayments, as well as distribution and power supply loans sold to the Federal Agricultural Mortgage Corporation totaling $327 million, of which $164 million were advanced at the time of sale, and by $75 million of loans prepaid at their repricing date. RTFC loans as a percentage of our total loan portfolio decreased from 9 percent at May 31, 2010 to 4 percent at May 31, 2011 as a result of the $536 million reduction in non-performing loans to ICC and the prepayment of $204 million of telecommunications loans related to the acquisition of one of our borrowers.

The percentage of long-term fixed-rate loans increased to 85 percent at May 31, 2011 from 80 percent at May 31, 2010 and from 73 percent at May 31, 2009. The increase in long-term fixed-rate loans during fiscal year 2011 was due to new long-term fixed-rate loan advances, partially offset by $33 million in net conversions from long-term fixed to long-term variable interest rates. For the year ended May 31, 2010, the net conversions from a variable rate to a fixed rate totaled $822 million. The high level of fixed-rate loan advances in fiscal year 2011 and the significant conversions of variable-rate loans to fixed interest rates in fiscal year 2010 were the result of members taking advantage of historically low rates by locking down a fixed interest rate on their loans.

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

(dollar amounts in thousands)	2011 Amount	% of Total	2010 Amount	% of Total	Increase/ (Decrease)
CFC:					
Distribution	$ 13,977,327}	68%	$13,680,956	67%	$ 296,371}
Power supply	4,909,908}	24	4,654,622	22	255,286}
Statewide and associate	109,768}	1	108,214	1	1,554}
CFC total	18,997,003}	93	18,443,792	90	553,211}
RTFC	859,943}	4	1,672,529	8	(812,586)
NCSC	572,718}	3	393,193	2	179,525}
Total	$ 20,429,664}	100%	$20,509,514	100 %	$ (79,850)

Credit Concentration

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

The service territories of our electric and telecommunications members are located throughout the United States and its territories, including 49 states, the District of Columbia and two U.S. territories. At May 31, 2011 and 2010, loans outstanding to members in any one state or territory did not exceed 19 percent and 17 percent of total loans outstanding, respectively.

At May 31, 2011 and 2010, the total exposure outstanding to any one borrower or controlled group did not exceed 2.4 percent and 2.6 percent, respectively, of total loans and guarantees outstanding. At May 31, 2011, the 10 largest borrowers included four distribution systems and six power supply systems. At May 31, 2010, the 10 largest borrowers included three distribution systems, six power supply systems and one telecommunications system. The following table shows the exposure to the 10 largest borrowers as a percentage of total exposure presented by type of exposure and borrower type at May 31:

	2011		2010		
(dollar amounts in thousands)	Amount	% of Total	Amount	% of Total	Increase/ (Decrease)
Total by type:					
Loans	$ 3,206,808}	16%	$ 3,478,271	17%	$ (271,463)
Guarantees	302,771}	1	342,325	2	(39,554)
Total credit exposure to 10 largest borrowers	$ 3,509,579}	17 %	$ 3,820,596	19 %	$ (311,017)
Total by borrower type:					
CFC	$ 3,488,329}	17%	$ 3,274,247	16%	$ 214,082}
RTFC	-}	-	523,849	3	(523,849)
NCSC	21,250}	-	22,500	-	(1,250)
Total credit exposure to 10 largest borrowers	$ 3,509,579}	17 %	$ 3,820,596	19 %	$ (311,017)

Security Provisions

Except when providing line of credit loans, we typically lend to our members on a senior secured basis. Long-term loans are typically secured on parity with other secured lenders (primarily RUS), if any, by all assets and revenue of the borrower with exceptions typical in utility mortgages. Line of credit loans are generally unsecured. Guarantee reimbursement obligations are typically secured on parity with other secured creditors by substantially all assets and revenue of the borrower or by the underlying financed asset. In addition to the collateral pledged to secure our loans, borrowers are also required to set rates charged to customers to achieve certain financial ratios.

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

	2011	2010

(dollar amounts in thousands)	Amount	% of Total	Amount	% of Total	Increase/ (Decrease)
Total by type:					
Loans	$ 2,200,140}	11%	$ 2,041,099	10%	$ 159,041}
Guarantees	281,431}	1	320,761	2	(39,330)
Total unsecured credit exposure	$ 2,481,571}	12%	$ 2,361,860	12%	$ 119,711}
Total by borrower type:					
CFC	$ 2,041,440}	10%	$ 2,049,365	10%	$ (7,925)
RTFC	231,923}	1	242,548	2	(10,625)
NCSC	208,208}	1	69,947	-	138,261}
Total unsecured credit exposure	$ 2,481,571}	12%	$ 2,361,860	12%	$ 119,711}

Pledged Loans and Loans on Deposit

The following table summarizes our secured debt or debt requiring collateral on deposit, the excess collateral pledged and our unencumbered loans at May 31:

(dollar amounts in thousands)	2011	2010
Total loans to members	$ 19,324,676}	$ 19,338,405
Less: Total secured debt or debt requiring collateral on deposit (1)	(10,111,094)	(10,094,301)
Excess collateral pledged or on deposit (2)	(1,668,457)	(1,834,358)
Unencumbered loans	$ 7,545,125}	$ 7,409,746
Unencumbered loans as a percentage of total loans	39}%	38%

(1) Excludes debt secured by cash collateral only.

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

Non-performing and Restructured Loans

The following table presents a summary of non-performing and restructured loans as a percentage of total loans and total loans and guarantees outstanding at May 31:

(dollar amounts in thousands)	2011	2010	2009	2008	2007
Non-performing loans (1)	$ 31,344	$ 560,527	$ 523,758	$ 506,864	$ 501,864
Percent of loans outstanding	0.16%	2.90%	2.59%	2.67%	2.77%
Percent of loans and guarantees outstanding	0.15	2.73	2.44	2.52	2.61
Restructured loans	$ 474,381	$ 508,044	$ 537,587	$ 577,111	$ 603,305
Percent of loans outstanding	2.45%	2.63%	2.66%	3.03%	3.33%
Percent of loans and guarantees outstanding	2.32	2.48	2.50	2.88	3.14
Total non-performing and restructured loans	$ 505,725	$ 1,068,571	$1,061,345	$1,083,975	$1,105,169
Percent of loans outstanding	2.61%	5.53%	5.25%	5.70%	6.10%
Percent of loans and guarantees outstanding	2.47	5.21	4.94	5.40	5.75
Total non-accrual loans	$ 465,312	$ 1,022,924	$1,014,585	$1,026,121	$1,046,561
Percent of loans outstanding	2.41%	5.29%	5.03%	5.39%	5.77%
Percent of loans and guarantees outstanding	2.28	4.99	4.73	5.11	5.45

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

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

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

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

Non-performing loans at May 31, 2011 and 2010 included $31 million and $25 million, respectively, to an electric distribution cooperative in the process of developing geothermal generation capability. This borrower filed for bankruptcy in September 2010. Non-performing loans also included $536 million to ICC at May 31, 2010.

Based on our analysis, we believe we have an adequate loan loss allowance for our exposure related to non-performing loans at May 31, 2011.

RTFC was the primary secured lender to ICC and all loans to ICC were on non-accrual status since February 1, 2005. RTFC has assigned to CFC its rights with respect to the entities transferred as partial repayment of its loan from CFC. On October 6, 2010, CAH obtained control of 100 percent of the equity interests of ICC’s USVI operating entities and on March 1, 2011, CAH obtained control of 100 percent of the equity interests of ICC’s British Virgin Island and St. Maarten operating entities.

As a result, the ICC loan balance decreased from $536 million at May 31, 2010 to zero based on the following activity during the year ended May 31, 2011.

(dollar amounts in thousands)	
ICC loan balance at May 31, 2010	$ 536,027
Plus: Loan advances prior to transfer of control	2,197
ICC loan balance at October 6, 2010	538,224
Activity resulting from transfer of control:	
Payments to third parties under inter-creditor agreement and transaction fees	14,000
Fair value of ICC's operating entities transferred	(165,625)
Redemption of an ICC subsidiary's preferred stock	(30,000)
Offset for patronage capital allocated to ICC by RTFC	(2,351)
ICC loan charge-off	$ 354,248

CFC recorded an initial investment of $254 million to foreclosed assets, which includes the $166 million fair value of the entities transferred and an additional investment of $88 million to these entities to pay down or fully settle third-party debt obligations outstanding prior to the transfer. The fair value of $166 million for the entities transferred included $88 million of third-party debt obligations. The $88 million of third-party debt obligations was paid off with the $88 million additional investment made by CFC as part of the transfer of control. See further discussion in Note 4, Foreclosed Assets to the consolidated financial statements.

When agreements are executed to change the original terms of a loan, generally a change to the originally scheduled cash flows, we classify the loan as restructured unless the new terms are deemed to be market terms. We make a determination about the accrual of interest income for these loans on a loan-by-loan basis. The initial decision is based on the terms of the restructure agreement and the anticipated performance of the borrower over the term of the agreement. We periodically review the decision whether or not to accrue interest income on restructured loans based on the borrower's past performance and current financial condition.

At May 31, 2011 and 2010, we had restructured loans totaling $474 million to two borrowers and $508 million to three borrowers, respectively, all of which were performing according to their restructure agreements. Approximately $3 million of interest income was accrued on restructured loans during the years ended May 31, 2011 and 2010.

At May 31, 2011 and 2010, we had $434 million and $462 million, respectively, of restructured loans outstanding to a large electric distribution cooperative that provides retail electric service to residential and business customers. All restructured loans to this borrower have been on non-accrual status since January 1, 2001. During the year ended May 31, 2011, this borrower made scheduled payments of $28 million, all of which were applied as a reduction to the loan principal balance and resulted in a reduction of $21 million to the calculated impairment. There has been no principal written off on the exposure to this borrower. In addition, a total of $20 million was outstanding under a capital expenditure loan facility, which was classified as a performing loan at both May 31, 2011 and 2010. Total loans to this borrower at May 31, 2011 and 2010 represented 2.2 percent and 2.4 percent of our total loans and guarantees outstanding, respectively.

Under the terms of a bankruptcy settlement from 2002, we restructured the loans to this electric distribution cooperative. This borrower is scheduled to make quarterly payments to us through December 2037. As part of the restructuring, we may be obligated to provide up to $204 million of senior secured capital expenditure loans to this borrower for electric distribution infrastructure through December 2012. Under the facility, advances are limited to $46 million per year. As of the date of this filing, there is $92 million available under this loan facility. When this borrower requests capital expenditure loans under this facility, these loans are made at the standard terms offered to all borrowers and require debt service payments in addition to the quarterly payments that it is required to make on the restructured loan. To date, this borrower has made all payments required under the restructure agreement and capital expenditure loan facility. Under the terms of the restructure agreement, this borrower has the option to prepay the loan for the lesser of their outstanding balance or $405 million plus an interest payment true-up on or after December 13, 2008. To date, we have not received notice from this borrower that it intends to prepay the loan.

Based on our analysis, we believe we have an adequate loan loss allowance for our exposure related to restructured loans at May 31, 2011.

Allowance for Loan Losses

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

Under a guarantee agreement, CFC reimburses RTFC and NCSC for loan losses, therefore, RTFC and NCSC do not maintain separate loan loss reserves. Activity in the allowance for loan losses is summarized below including a disaggregation of the allowance for loan losses held at CFC based on borrower type as of and for the years ended May 31:

	As of and for the years ended May 31,				
(dollar amounts in thousands)	2011	2010	2009	2008	2007
Beginning balance	$ 592,764}	$622,960	$514,906	$561,663	$611,443
(Recovery of) provision for loan losses	(83,010)	(30,415)	113,699	(30,262)	(6,922)
Net (charge-offs) recoveries	(348,577)	219	(5,645)	(16,495)	(42,858)
Ending balance	$ 161,177}	$592,764	$622,960	$514,906	$561,663
`					
Loan loss allowance by borrower type:					
CFC (1)	$ 143,706	$177,655	$224,688	$247,443	$320,342
RTFC (1)	8,389	406,214	378,194	244,567	219,288
NCSC (1)	9,082	8,895	20,078	22,896	22,033
Total	$ 161,177	$592,764	$622,960	$514,906	$561,663
As a percentage of total loans outstanding	0.84%	3.07%	3.09%	2.71%	3.10%
As a percentage of total non-performing loans outstanding	514.22	105.75	118.94	101.59	111.95
As a percentage of total restructured loans outstanding	33.98	116.68	115.88	89.22	93.20
As a percentage of total loans on non-accrual	34.64	57.95	61.40	50.18	53.67

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

Our loan loss allowance decreased by $432 million from May 31, 2010 to May 31, 2011 primarily due to the charge-off of $354 million related to the transfer of ICC's operating entities to CAH during fiscal year 2011 described further in the Non-performing and Restructured Loans section above. See Recovery of (Provision for) Loan Losses in the Results of Operations section for more details about the recovery of loan losses for the year ended May 31, 2011. On a quarterly basis, we review all non-performing and restructured borrowers, as well as certain additional borrowers selected based on known facts and circumstances, to determine if the loans to the borrower are impaired and/or to determine if there are changes to a previously impaired loan. We calculate a borrower's impairment based on the expected future cash flows or the fair value of the collateral securing our loans to the borrower if cash flow cannot be estimated. As events related to the borrower take place and economic conditions and our assumptions change, the impairment calculations will change. At May 31, 2011 and 2010, there was a total specific loan loss allowance balance of $37 million and $437 million, respectively, related to impaired loans totaling $506 million and $1,064 million, respectively.

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

	2011		2010		2009	
(dollar amounts in thousands)	Amounts Outstanding	Weighted-Average Interest Rate	Amounts Outstanding	Weighted-Average Interest Rate	Amounts Outstanding	Weighted-Average Interest Rate
Commercial paper (1)	$ 3,025,370}	0.23%	$ 2,264,230	0.30%	$ 1,833,273	0.31%
Bank bid notes	295,000}	0.60	30,000	0.60	255,000	1.46
Term loan	-}	-}	-	-	200,000	3.31
Collateral trust bonds	5,513,235}	5.56	5,469,245	5.76	5,178,756	6.05
Notes payable	4,633,854}	3.45	4,666,518	3.93	4,256,661	4.22
Medium-term notes	3,656,274}	5.96	4,230,865	6.00	5,864,229	5.88
Subordinated deferrable debt	186,440}	6.02	311,440	6.31	311,440	6.31
Membership certificates	646,161}	4.90	643,211	4.90	642,960	4.90
Loan and guarantee certificates	769,241}	2.91	769,654	2.79	818,999	2.73
Member capital securities	398,250}	7.50	397,850	7.50	278,095	7.50
Total debt outstanding	$ 19,123,825}	4.12	$ 18,783,013	4.59	$ 19,639,413	4.83
Percentage of fixed-rate debt (2)	79%		81%		87%	
Percentage of variable-rate debt (3)	21		19		13	
Percentage of long-term debt	83%		88%		89%	
Percentage of	17		12		11	

short-term
debt

(1) Includes $309 million and $372 million related to the daily liquidity fund at May 31, 2011 and 2010, respectively.
(2) Includes variable-rate debt that has been swapped to a fixed rate net of any fixed-rate debt that has been swapped to a variable rate.
(3) The rate on commercial paper notes does not change once the note has been issued. However, the rates on new commercial paper notes change daily, and commercial paper notes generally have maturities of less than 90 days. Therefore, commercial paper notes are classified as variable-rate debt. Also includes fixed-rate debt that has been swapped to a variable rate net of any variable-rate debt that has been swapped to a fixed rate.

Total debt outstanding increased by $341 million at May 31, 2011 as compared with May 31, 2010 primarily due to the need to fund the $418 million increase to total assets. The increase to total assets was primarily due to increases of $420 million to net loans outstanding and $239 million to the balance of foreclosed assets offset by the reduction of $220 million to the balance of cash. Commercial paper and bank bid notes represented a higher percentage of the total debt outstanding at May 31, 2011 compared with the percentage at May 31, 2010 as a result of its use to refinance maturing term debt during the period. In July 2010, $400 million of variable-rate collateral trust bonds matured, and in October 2010, $500 million of 4.375 percent collateral trust bonds matured. In September 2010, we redeemed $125 million of 6.75 percent subordinated deferrable debt. Additionally, maturities of medium-term notes exceeded new advances by $575 million during the year ended May 31, 2011. These debt maturities were refinanced with a combination of commercial paper and collateral trust bonds.

The following table provides additional information on our outstanding debt instruments at May 31, 2011.

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

(1) The rate on bank bid notes and commercial paper notes does not change once the note has been issued. However, the rates on new bank bid notes and commercial paper notes change daily, and bank bid notes and commercial paper notes generally have maturities of less than 90 days. Therefore, we consider bank bid notes and commercial paper notes to be variable-rate debt in our financial analysis.
(2) Secured by the pledge of permitted investments and eligible mortgage notes from distribution system borrowers in an amount at least equal to the outstanding principal amount of collateral trust bonds.
(3) Represents notes payable issued to the Federal Financing Bank with a guarantee of repayment by RUS under the Guaranteed Underwriter program of the U.S. Department of Agriculture, which supports the Rural Economic Development Loan and Grant program. We are required to maintain collateral on deposit equal to at least 100 percent of the outstanding balance of debt.
(4) We are required to pledge eligible mortgage notes from distribution and power supply system borrowers in an amount at least equal to the outstanding principal amount under note purchase agreements with the Federal Agricultural Mortgage Corporation.
(5) At May 31, 2011, other notes payable includes unsecured and secured Clean Renewable Energy Bonds. We are required to pledge eligible mortgage notes from distribution and power supply system borrowers in an amount at least equal to the outstanding principal amount under the Clean Renewable Energy Bonds Series 2009A note purchase agreement. The remaining other notes payable relate to unsecured notes payable issued by NCSC.
(6) We have the right at any time and from time to time during the term of the subordinated deferrable debt to suspend interest payments for a period not exceeding 20 consecutive quarters. We have the right to call the subordinated deferrable debt any time after five years, at par. To date, we have not exercised our option to suspend interest payments.
(7) Subordinate and junior in right of payment to senior debt and the debt obligations we guarantee, but senior to subordinated certificates.
(8) Membership subordinated certificates generally mature 100 years from issuance. Loan and guarantee subordinated certificates have the same maturity as the related long-term loan. Some certificates may also amortize annually based on the outstanding loan balance. Member capital securities mature 35 years from issuance. Member capital securities are callable at par by CFC starting five years from the date of issuance and anytime thereafter.
(9) Subordinate and junior in right of payment to senior and subordinated debt and debt obligations we guarantee.

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

	2011		2010		2009	
(dollar amounts in thousands)	Debt Outstanding	Weighted-Average Interest Rate	Debt Outstanding	Weighted-Average Interest Rate	Debt Outstanding	Weighted-Average Interest Rate
Short-term debt:						
Total commercial paper	$ 2,716,645}	0.24%	$ 1,892,520	0.31%	$ 1,541,932	0.33%
Daily liquidity fund sold directly to members	308,725}	0.15	371,710	0.24	291,341	0.22
Term loan	-}	-	-	-	200,000	3.31
Bank bid notes	295,000}	0.60	30,000	0.60	255,000	1.46
Subtotal short-term debt	3,320,370}	0.27	2,294,230	0.30	2,288,273	0.70
Long-term debt maturing within one year	2,522,554}	5.04	2,312,131	3.21	2,579,591	4.49
Total short-term debt	$ 5,842,924}	2.33	$ 4,606,361	1.76	$ 4,867,864	2.71

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

(dollar amounts in thousands)	2011	2010	2009
Weighted-average maturity outstanding at year-end:			
Commercial paper	29 days	27 days	27 days
Daily liquidity fund sold directly to members	1 day	1 day	1 day
Term loan	-	-	235 days
Bank bid notes	33 days	12 days	15 days
Subtotal short-term debt	27 days	23 days	41 days
Long-term debt maturing within one year	249 days	137 days	131 days
Total	123 days	80 days	89 days
Average amount outstanding during the year:			
Commercial paper	$ 2,698,653	$1,822,745	$ 2,638,792
Daily liquidity fund sold directly to members	343,311	353,688	314,312
Term loan and bank lines of credit	-	-	118,208
Bank bid notes	208,333	102,083	209,583
Subtotal short-term debt	3,250,297	2,278,516	3,280,895
Long-term debt maturing within one year	1,550,369	2,164,554	2,688,165
Total	$ 4,800,666	$4,443,070	$ 5,969,060
Maximum amount outstanding at any month-end during the year:			
Commercial paper	$ 3,424,449	$2,634,838	$ 3,709,130
Daily liquidity fund sold directly to members	440,806	537,705	364,994
Term loan and bank lines of credit	-	-	418,500
Bank bid notes	295,000	225,000	300,000
Subtotal short-term debt	3,975,621	3,180,865	4,183,905
Long-term debt maturing within one year	2,522,554	2,659,650	4,224,816

Equity

Equity includes the following components at May 31:

(dollar amounts in thousands)	2011	2010	Increase/ (Decrease)
Membership fees	$ 994}	$ 991	$ 3}
Education fund	1,437}	1,457	(20)
Members' capital reserve	272,126}	191,993	80,133}
Allocated net income	521,897}	481,120	40,777}
Unallocated net loss (1)	(6,213)	(6,206)	(7)
Total members' equity	790,241}	669,355	120,886}
Prior years cumulative derivative forward value and foreign currency adjustments	(100,778)	(103,493)	2,715}
Year-to-date derivative forward value (loss) gain (2)	(23,698)	2,715	(26,413)
Total CFC retained equity	665,765}	568,577	97,188}
Accumulated other comprehensive income	9,758}	8,004	1,754}
Total CFC equity	675,523}	576,581	98,942}
Noncontrolling interest	11,786}	10,186	1,600}
Total equity	$ 687,309}	$ 586,767	$ 100,542}

(1) Excludes derivative forward value.

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

At May 31, 2011, total equity increased by $101 million from May 31, 2010 largely due to net income of $151 million for the year ended May 31, 2011, partially offset by the board-authorized patronage capital retirement of $51 million. 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. Under current guidelines of CFC's Board of Directors, beginning in June 2009 we retire 50 percent of the prior year's allocated net earnings and hold the remaining 50 percent for 25 years. The retirement amount and timing remains subject to annual approval by CFC's Board of Directors.

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

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

In accordance with District of Columbia cooperative law, its bylaws and board policies, RTFC allocates its net earnings to its patrons, a cooperative educational fund and a general reserve, if necessary. RTFC's bylaws require that it allocate at least 1 percent of net earnings to a cooperative educational fund. An allocation to the general fund is made, if necessary, to maintain the balance of the general fund at 50 percent of the membership fees collected. The remainder is allocated to borrowers in proportion to their patronage. RTFC retires at least 20 percent of the allocation for that year to members in cash prior to filing the applicable tax return. Any additional amounts are retired as determined by the Board of Directors with due regard for RTFC’s financial condition. In January 2011, RTFC retired $1 million to its members representing 20 percent of allocated net earnings for fiscal year 2010. In accordance with District of Columbia cooperative law and its bylaws and board policies, NCSC allocates its net earnings to a cooperative educational fund, to a general fund, if necessary, and to board-approved reserves. NCSC’s bylaws require the allocation to the cooperative educational fund to be at least 0.25 percent of its net earnings. An allocation to the general fund is made, if necessary, to maintain the balance of the general fund at 50 percent of the membership fees collected. To date, NCSC has not allocated net earnings to its members. The NCSC Board of Directors has the authority to determine when and if net earnings will be allocated and retired to members.

Contractual Obligations

The following table summarizes our long-term contractual obligations at May 31, 2011 and the scheduled reductions by fiscal year and thereafter:

(dollar amounts in millions)

Contractual Obligations (1)	2012	2013	2014	2015	2016	Thereafter	Total
Long-term debt due in less than one year	$2,523	$ -	$ -	$ -	$ -	$ -	$ 2,523
Long-term debt	-	697	2,381	445	986	6,784	11,293
Subordinated deferrable debt	-	-	-	-	-	186	186
Members' subordinated certificates (2)	-	60	31	33	16	1,477	1,617
Operating leases (3)	1	-	-	-	-	-	1
Contractual interest on long-term debt (4)	729	635	565	515	497	6,201	9,142
Total contractual obligations	$ 3,253	$ 1,392	$ 2,977	$ 993	$ 1,499	$ 14,648	$ 24,762

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

(2) Excludes loan subordinated certificates totaling $184 million that amortize annually based on the outstanding balance of the related loan. There are many items that affect the amortization of a loan, such as loan conversions, loan repricing at the end of an interest rate term and prepayments; therefore, an amortization schedule cannot be maintained for these certificates. Over the past three years, annual amortization on these certificates has averaged $23 million. In fiscal year 2011, amortization represented 16 percent of amortizing loan subordinated certificates outstanding.

(3) Represents the payment obligation related to our lease of office space for our headquarters facility through the term of the lease ending on October 17, 2011.

(4) Represents the interest obligation on our debt based on terms and conditions at May 31, 2011.

Off-Balance Sheet Obligations

Guarantees

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

(dollar amounts in thousands)	2011	2010	Increase/ (Decrease)
Total by guarantee type:			
Long-term tax-exempt bonds	$ 599,935}	$ 601,625	$ (1,690)
Indemnifications of tax benefit transfers	59,895}	69,982	(10,087)
Letters of credit	327,201}	380,076	(52,875)
Other guarantees	117,957}	119,426	(1,469)
Total	$ 1,104,988}	$1,171,109	$ (66,121)
Total by borrower type:			
CFC	$ 1,055,524}	$1,128,763	$ (73,239)
RTFC	821}	636	185}
NCSC	48,643}	41,710	6,933}
Total	$ 1,104,988}	$1,171,109	$ (66,121)

In addition to the letters of credit listed in the table, under master letter of credit facilities in place at May 31, 2011, we may be required to issue up to an additional $700 million in letters of credit to third parties for the benefit of our members. At May 31, 2010, this amount was $473 million. New issuances of letters of credit under these master facilities are subject to material adverse change clauses at the time of issuance. Prior to issuing a letter of credit, we would confirm that there has been no material adverse change in the business condition, financial or otherwise, of the borrower since the time the loan was approved and confirm that the borrower is currently in compliance with the letter of credit terms and conditions.

We guarantee certain contractual obligations of our members so that they may obtain various forms of financing. We use the same credit policies and monitoring procedures in providing guarantees as we do for loans and commitments. If a member system defaults on its obligation to pay debt service, then we are obligated to pay any required amounts under our guarantees. Meeting our guarantee obligations satisfies the underlying obligation of our member systems and prevents the exercise of remedies by the guarantee beneficiary based upon a payment default by a member system. In general, the member system is required to repay, on demand, any amount advanced by us with interest, pursuant to the documents evidencing the member system's reimbursement obligation. At May 31, 2011 and 2010, 75 percent and 73 percent, respectively, of total guarantees were secured by a mortgage lien on substantially all of the system's assets and future revenue. Members' interest expense for the years ended May 31, 2011 and 2010 on debt obligations that we guaranteed was approximately $6 million and $13 million, respectively, representing the amount of interest that we would have to pay in a year if our members were to default.

The decrease in total guarantees during the year ended May 31, 2011 is primarily due to normal amortization of guaranteed debt and maturing letters of credit, partially offset by two new tax-exempt bonds totaling $24 million issued during the period. At May 31, 2011 and 2010, we recorded a guarantee liability totaling $22 million and $23 million, respectively, which represents the contingent and non-contingent exposure related to guarantees and liquidity obligations associated with members' debt.

The following table summarizes the off-balance sheet obligations at May 31, 2011, and the related maturities by fiscal year and thereafter as follows:

		Maturities of Guaranteed Obligations					
(dollar amounts in thousands)	Outstanding Balance	2012	2013	2014	2015	2016	Thereafter
Guarantees (1)	$1,104,988	$345,054	$139,285	$60,659	$89,370	$22,662	$447,958

(1) On a total of $524 million of tax-exempt bonds, we have unconditionally agreed to purchase bonds tendered or called for redemption at any time if the remarketing agents have not sold such bonds to other purchasers.

Contingent Off-Balance Sheet Obligations

Unadvanced Loan Commitments

Unadvanced commitments represent approved and executed loan contracts for which the funds have not been advanced. At May 31, 2011 and 2010, we had the following amount of unadvanced commitments on loans to our borrowers.

(dollar amounts in thousands)	2011	% of Total	2010	% of Total
Long-term	$ 5,461,484}	39%	$ 5,154,990	36%
Line of credit	8,609,191}	61	9,039,448	64
Total	$ 14,070,675}	100%	$14,194,438	100%

A total of $999 million and $931 million of line of credit unadvanced commitments at May 31, 2011 and 2010, respectively, represented unadvanced commitments related to line of credit loans that are not subject to a material adverse change clause at the time of each loan advance. As such, we would be required to advance amounts on these committed facilities as long as the borrower is in compliance with the terms and conditions of the loan. The remaining available amounts at May 31, 2011 and 2010 were generally subject to material adverse change clauses. Prior to making an advance on these facilities, we confirm that there has been no material adverse change in the business condition, financial or otherwise, of the borrower since the time the loan was approved and confirm that the borrower is currently in compliance with loan terms and conditions.

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

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

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

- electric cooperatives typically execute loan contracts to cover multi-year work plans and, as such, it is expected that advances on such loans will occur over a multi-year period;
- electric cooperatives generate a significant amount of cash from the collection of revenue from their customers, so they usually do not need to draw down on loan commitments to supplement operating cash flow;
- we generally do not charge our borrowers a fee on long-term unadvanced commitments; and
- long-term unadvanced commitments generally expire within five years of the first advance on a loan.

Unadvanced commitments that are subject to a material adverse change clause are classified as contingent liabilities. Based on the conditions to advance funds described above, the majority of our unadvanced loan commitments do not represent off-balance sheet liabilities and have not been included in the table summarizing off-balance sheet obligations. We do, however, record a reserve for credit losses associated with our unadvanced commitments for committed facilities that are not subject to a material adverse change clause. The following table summarizes the available balance under committed lines of credit at May 31, 2011, and the related notional maturities by fiscal year as follows:

		Notional Maturities of Committed Lines of Credit				
(dollar amounts in thousands)	Available Balance	2012	2013	2014	2015	2016
Committed lines of credit	$998,710	$195,285	$211,641	$423,854	$93,125	$74,805

Ratio Analysis

Leverage Ratio

The leverage ratio is calculated by dividing the sum of total liabilities and guarantees outstanding by total equity. Based on this formula, the leverage ratio at May 31, 2011 was 30.52-to-1, a decrease from 35.33-to-1 at May 31, 2010. The decrease in the leverage ratio is due to the increase of $101 million in total equity and the decrease of $66 million in guarantees, offset by the increase of $318 million in total liabilities as discussed under the Liabilities and Equity section and the Off-Balance Sheet Obligations section of Financial Condition.

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

At May 31, 2011 and 2010, the adjusted leverage ratio was 6.48-to-1 and 6.34-to-1, respectively. See Non-GAAP Financial Measures for further explanation and a reconciliation of the adjustments we make to our leverage ratio calculation. The increase in the adjusted leverage ratio is due to the increase of $456 million in adjusted liabilities, partially offset by the decrease of $66 million to guarantees as discussed under the Liabilities and Equity section and the Off-Balance Sheet Obligations section of Financial Condition. In addition to the adjustments made to the leverage ratio in the Non-GAAP Financial Measures section, guarantees to member systems that have certain investment-grade ratings from Moody's Investors Service and Standard & Poor's Corporation are excluded from the calculation of the leverage ratio under the terms of the revolving credit agreements.

Debt-to-Equity Ratio

The debt-to-equity ratio is calculated by dividing the sum of total liabilities outstanding by total equity. The debt-to-equity ratio, based on this formula at May 31, 2011, was 28.92-to-1, a decrease from 33.33-to-1 at May 31, 2010. The decrease in the debt-to-equity ratio is due to an increase of $101 million in total equity offset by an increase of $318 million in total liabilities as discussed under the Liabilities and Equity section of Financial Condition.

For internal management purposes, the debt-to-equity ratio calculation is adjusted to exclude derivative liabilities, debt used to fund loans guaranteed by RUS, subordinated deferrable debt and subordinated certificates from liabilities; uses members' equity rather than total equity; and adds subordinated deferrable debt and subordinated certificates to determine adjusted equity. At May 31, 2011 and 2010, the adjusted debt-to-equity ratio was 6.09-to-1 and 5.93-to-1, respectively. See Non-GAAP Financial Measures for further explanation and a reconciliation of the adjustments made to the debt-to-equity ratio calculation. The increase in the adjusted debt-to-equity ratio is due to the increase of $456 million in adjusted liabilities.

Liquidity and Capital Resources

The following section discusses our expected sources and uses of liquidity. At May 31, 2011, we expect that our current sources of liquidity will allow us to issue the debt required to fund our operations over the next 12 to 18 months.

The table below shows the projected sources and uses of cash by quarter through November 30, 2012. In analyzing our projected liquidity position, we track key items identified in the chart below. The long-term debt maturities represent the scheduled maturities of our outstanding term debt for the period presented. The long-term loan advances represent our current best estimate of the member demand for our loans, the amount and the timing of which are subject to change. The long-term loan amortization and prepayments represent the scheduled long-term loan amortization for the outstanding loans at May 31, 2011, as well as our current estimate for the prepayment of long-term loans. The estimate of the amount and timing of long-term loan prepayments is subject to change. We assumed the issuance of commercial paper, medium-term notes and other long-term debt, including collateral trust bonds and private placement of term debt, to maintain matched funding within our loan portfolio and to allow our revolving lines of credit to provide backup liquidity for our outstanding commercial paper. Commercial paper repayments in the table below do not represent scheduled maturities but rather the assumed use of excess cash to pay down the commercial paper balance.

	Projected Uses of Liquidity				Projected Sources of Liquidity					
						Debt Issuance				
(dollar amounts in millions)	Long-term debt maturities	Debt repayment-commercial paper	Long-term loan advances	Total uses of liquidity	Long-term loan amortization & prepayment	Commercial paper	Other long-term debt	Medium term notes	Total sources of liquidity	Cumulat excess source over us of liquidit
4Q11										$ 29
1Q12	$ 375	$ -	$ 214	$ 589	$ 362	$ 200	$ -	$ 100	$ 662	36
2Q12	191	175	185	551	459	-	-	100	559	37
3Q12	364	-	315	679	364	-	150	350	864	56
4Q12	1,593	-	156	1,749	376	400	450	350	1,576	38
1Q13	267	-	317	584	313	-	150	100	563	36
2Q13	269	200	106	575	511	-	-	100	611	40
Totals	$ 3,059	$ 375	$ 1,293	$ 4,727	$ 2,385	$ 600	$ 750	$ 1,100	$ 4,835	

The above chart represents our best estimate of the funding requirements and how we expect to manage such funding requirements through November 30, 2012. These estimates will change on a quarterly basis based on many factors.

Sources of Liquidity

Capital Market Debt Issuance

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

- unlimited amount of collateral trust bonds until September 2013;
- unlimited amount of medium-term notes, member capital securities and subordinated deferrable debt until November 2011 (at which time we expect to file a new registration statement that will be effective until November 2014); and
- daily liquidity fund for a total of $20,000 million with a $3,000 million limitation on the aggregate principal amount outstanding at any time until April 2013.

During fiscal year 2011, we issued $1,200 million under three underwritten registered offerings. 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. In February 2011, we issued $300 million of 3.050 percent collateral trust bonds due 2016. In March 2011, we issued $250 million of nine-month floating-rate medium-term notes in a registered offering.

During the second quarter of fiscal year 2011, we elected to re-enter the retail notes market. Additional market funding through the issuance of retail notes had been unnecessary since November 2009 when the outstanding balance had reached $1,093 million. We plan to use retail notes as a supplemental source of unsecured funding during fiscal year 2012. The total balance of retail notes outstanding was $521 million at May 31, 2011.

In addition, we have a commercial paper program to sell commercial paper to investors in the capital markets. We limit the amount of commercial paper that can be sold to the amount of backup liquidity available under our revolving credit agreements. Commercial paper issued through dealers and bank bid notes totaled $1,767 million and represented 9 percent of total debt outstanding at May 31, 2011. We intend to maintain the balance of dealer commercial paper and bank bid notes at 15 percent or less of total debt outstanding during fiscal year 2012.

Private Debt Issuance

We have access to liquidity from private debt issuances through note purchase agreements with the Federal Agricultural Mortgage Corporation. At May 31, 2011 and 2010, we had secured notes payable of $1,411 million and $1,587 million outstanding to the Federal Agricultural Mortgage Corporation under note purchase agreements totaling $3,900 million and $2,400 million, respectively. In January 2011, we entered into a new $1,500 million revolving note purchase agreement with the Federal Agricultural Mortgage Corporation. All note purchase agreements previously entered into with the Federal

Agricultural Mortgage Corporation were consolidated into one agreement in March 2011. Under the terms of the March 2011 note purchase agreement, we can borrow up to $3,900 million at any time from the date of the agreement through January 11, 2016 and thereafter automatically extend the agreement on each anniversary date of the closing for an additional year, unless prior to any such anniversary date, the Federal Agricultural Mortgage Corporation provides CFC with a notice that the draw period will not be extended beyond the then remaining term. The agreement with the Federal Agricultural Mortgage Corporation is a revolving credit facility that allows us to borrow, repay and re-borrow funds at any time through maturity or from time to time as market conditions permit, provided that the principal amount at any time outstanding under the note purchase agreement is not more than the total available under the agreement. Each borrowing under a note purchase agreement is evidenced by a secured note setting forth the interest rate, maturity date and other related terms as we may negotiate with the Federal Agricultural Mortgage Corporation at the time of each such borrowing. We may select a fixed rate or variable rate at the time of each advance with a maturity as determined in the applicable pricing agreement.

In September 2010 and October 2010, we issued notes totaling $400 million to the Federal Agricultural Mortgage Corporation at rates ranging from 0.62 percent to 0.67 percent. These notes matured during the third quarter of fiscal year 2011. At May 31, 2011 and through the date of this filing, we have $2,489 million available under revolving note purchase agreements with the Federal Agricultural Mortgage Corporation, subject to market conditions for debt issued by the Federal Agricultural Mortgage Corporation.

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. In March 2011, we borrowed $150 million under this facility at a weighted average interest rate of 2.726 percent with a repricing period ranging from five to 12 years and a final maturity of 20 years.

On April 15, 2011, the President of the United States signed the Full-Year Continuing Appropriations Act for Fiscal Year 2011, which provided an additional $500 million as part of the funding mechanism for the Rural Economic Development Loan and Grant program. Specifically, this $500 million loan would be made to a cooperative lender by the Federal Financing Bank with a guarantee of repayment by RUS. The cooperative lender would pay fees to support the REDLG program. CFC has submitted an application to RUS for the $500 million, 20-year maturity RUS-guaranteed Federal Financing Bank loan authorized under this program. This loan, if awarded to CFC, would be available for advances during the three-year period following the date of closing. The amount approved to CFC under this program by the federal government by its fiscal year ending September 30, 2011 could range between $0 and $500 million.

Member Loan Repayments

Repayments on long-term loans are scheduled to average $1,046 million a year for fiscal years 2012 to 2016. Scheduled repayments include the principal amortization of long-term loans in each of the five fiscal years following May 31, 2011 and thereafter as follows:

(dollar amounts in thousands)		Amortization
2012 (1)	$	1,133,967
2013		1,297,242
2014		1,052,865
2015		877,775
2016		868,793
Thereafter		12,679,384
Total	$	17,910,026

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

Member Loan Interest Payments

During the year ended May 31, 2011, interest income on the loan portfolio was $997 million, representing an average yield of 5.15 percent compared with 5.22 percent and 5.38 percent for the years ended May 31, 2010 and 2009, respectively. For the past three fiscal years, interest income on the loan portfolio has averaged $1,030 million. At May 31, 2011, 86 percent of the total loans outstanding had a fixed rate of interest, and 14 percent of loans outstanding had a variable rate of interest. At May 31, 2011, 2 percent of loans outstanding were on non-accrual status.

Bank Revolving Credit Agreements

The following is a summary of the amounts available under our revolving credit agreements at May 31:

(dollar amounts in thousands)	2011	2010	Termination Date	Facility fee per year (1)
Five-year agreement	$ 1,049,000	$ 1,049,000	March 16, 2012	6 basis points
Three-year agreement	1,370,526	1,334,309	March 8, 2013	25 basis points
Three-year agreement	1,125,000	-	March 21, 2014	15 basis points
Five-year agreement	-	967,313	March 22, 2011	6 basis points
Total	$ 3,544,526	$ 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.

Effective November 15, 2010, we exercised our right to increase the aggregate amount of the commitment under the three-year revolving credit agreement expiring on March 8, 2013 by $50 million to a total of $1,385 million. We may request letters of credit for up to $100 million under this agreement, which then reduces the amount available under the facility. The available amount under this facility at May 31, 2011 and 2010 is reduced by total letters of credit outstanding of $14.5 million and $0.7 million, respectively.

On March 21, 2011, we replaced the $967 million five-year revolving credit agreement that terminated on March 22, 2011 with a new $1,125 million three-year agreement that expires on March 21, 2014. The facility fee is determined by pricing matrices in the agreement and is payable quarterly. We have the right to choose between a (i) Eurodollar rate plus an applicable margin to be determined by pricing matrices in the agreement or (ii) a base rate calculated based on the greater of prime rate, the federal funds effective rate plus 0.5 percent or the one-month LIBOR rate plus 1 percent, plus an applicable margin to be determined by pricing matrices in the agreement. We may request letters of credit for up to $100 million under the new three-year revolving credit agreement expiring on March 21, 2014, which then reduces the amount available under the facility. No letters of credit were outstanding at May 31, 2011. We also have the right, subject to certain terms and conditions, to increase the aggregate amount of the commitments under the new three-year revolving credit agreement by up to $375 million either by increasing the commitment of one or more existing lenders or by adding one or more new lenders, provided that no existing lender's commitment is increased without the consent of the lender and the administrative agent.

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

Member Investments

The table below shows the components of our member investments included in total debt outstanding at May 31:

(dollar amounts in thousands)	2011 Amount	2011 % of Total (1)	2010 Amount	2010 % of Total (1)	Increase/ (Decrease)
Commercial paper (2)	$ 1,498,495	50%	$ 1,371,159	61%	$ 127,336}

Medium-term notes	371,961	10	634,401	15	(262,440)
Members’ subordinated certificates	1,813,652	100	1,810,715	100	2,937}
Total	$ 3,684,108		$ 3,816,275		$ (132,167)
Percentage of total debt outstanding	19%		20%		

(1) Represents the percentage of each line item outstanding to our members.
(2) Includes $309 million and $372 million related to the daily liquidity fund at May 31, 2011 and 2010, respectively.

Member commercial paper investments averaged $1,122 million outstanding over the last three fiscal years. We view member commercial paper investments as a more stable source of funding than investor-purchased commercial paper.

Cash Flows from Operations

For the year ended May 31, 2011, cash flows provided by operating activities were $123 million compared with $84 million for the prior-year period. Our cash flows from operating activities are driven primarily by a combination of cash flows from operating income and the timing and amount of loan interest payments we received compared with interest payments we made on our debt.

Compliance with Debt Covenants

At May 31, 2011, we were in compliance with all covenants and conditions under our revolving credit agreements and senior debt indentures.

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

- The adjusted TIER, as defined by the agreements, represents the interest expense adjusted to include the derivative cash settlements plus net income prior to the cumulative effect of change in accounting principle and dividing that total by the interest expense adjusted to include the derivative cash settlements.
- The senior debt to total equity ratio includes adjustments to senior debt to exclude RUS-guaranteed loans, subordinated deferrable debt and members' subordinated certificates. Total equity is adjusted to include subordinated deferrable debt and members' subordinated certificates. Senior debt includes guarantees; however, it excludes:
  - guarantees for members where the long-term unsecured debt of the member is rated at least BBB+ by Standard & Poor's Corporation or Baa1 by Moody's Investors Service; and
  - the payment of principal and interest by the member on the guaranteed indebtedness if covered by insurance or reinsurance provided by an insurer having an insurance financial strength rating of AAA by Standard & Poor's Corporation or a financial strength rating of Aaa by Moody's Investors Service.

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

		Actual	
	Requirement	2011	2010
Minimum average adjusted TIER over the six most recent fiscal quarters	1.025	1.19	1.25
Minimum adjusted TIER for the most recent fiscal year (1)	1.05	1.21	1.12
Maximum ratio of adjusted senior debt to total equity	10.00	6.26	6.15

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

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

- under our indentures,
- related to taxes that are not delinquent or contested,
- stemming from certain legal proceedings that are being contested in good faith,
- created by CFC to secure guarantees by CFC of indebtedness the interest on which is excludable from the gross income of the recipient for federal income tax purposes,
- granted by any subsidiary to CFC, and
- to secure up to $7,500 million on any other indebtedness of CFC. As of May 31, 2011, the amount of our secured borrowings as defined under all three revolving credit agreements was $4,436 million.

The revolving credit agreements limit new investments in the ICC operating entities obtained by CAH as foreclosed assets to $275 million without consent by the required banks. These investments at May 31, 2011 did not exceed this limit.

The following represents our required and actual financial ratios as defined under our 1994 collateral trust bonds indenture and our medium-term notes indentures in the United States markets at May 31:

		Actual 1994 Collateral Trust Bonds and U.S. Medium-Term Notes Indentures	
	Requirement	2011	2010
Maximum ratio of adjusted senior debt to total equity	20.00	6.98	6.78

We are required to pledge collateral equal to at least 100 percent of the outstanding balance of debt issued under our collateral trust bond indentures and note purchase agreements with the Federal Agricultural Mortgage Corporation. We pledge distribution mortgage loans and permitted investments under our collateral trust bond indentures. We pledge distribution and power supply mortgage loans under the note purchase agreements with the Federal Agricultural Mortgage Corporation, which permit up to 20 percent of loans pledged to be from power supply systems. In addition, we are required to maintain collateral on deposit equal to at least 100 percent of the outstanding balance of debt outstanding to the Federal Financing Bank under the Guaranteed Underwriter program of the U.S. Department of Agriculture, which supports the Rural Economic Development Loan and Grant program, for which distribution and power supply loans may be deposited.

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

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

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

The $3,150 million of notes payable to the Federal Financing Bank as part of the funding mechanism for the Rural Economic Development Loan and Grant program at May 31, 2011 contain a rating trigger related to our senior secured credit ratings from Standard & Poor’s Corporation and Moody’s Investors Service. A rating trigger event occurs if our senior secured debt does not have at least two of the following ratings: (i) A- or higher from Standard & Poor’s Corporation, (ii) A3 or higher from Moody’s Investors Service and (iii) an equivalent rating from a successor rating agency to any of the above rating agencies. If our senior secured credit ratings fall below the levels listed above, the mortgage notes on deposit at that time, which totaled $3,616 million at May 31, 2011, would be pledged as collateral rather than held on deposit. Also, if during any portion of a fiscal year our senior secured credit ratings fall below the levels listed above, we may not make cash patronage capital distributions in excess of 5 percent of total patronage capital. At May 31, 2011, our senior secured debt ratings from Standard & Poor’s Corporation and Moody’s Investors Service were A+ and A1, respectively. At May 31, 2011, both Standard & Poor’s Corporation and Moody’s Investors Service had our ratings on stable outlook.

The following table summarizes the amount of collateral pledged or on deposit as a percentage of the related debt outstanding under the debt agreements noted above at May 31:

	Requirement		Actual	
Debt agreement	Debt Indenture Minimum	Revolving Credit Agreements Maximum	May 31, 2011	May 31, 2010
Collateral trust bonds	100%	150%	115%	114%
Federal Agricultural Mortgage Corporation	100	150	127	132
Clean Renewable Energy Bonds Series 2009A (1)	100	150	118	125
Federal Financing Bank (2)	100	150	115	119

(1) The limit of 150 percent on collateral pledged under the revolving credit agreements excludes cash pledged as collateral of $8 million and $13 million as of May 31, 2011 and 2010, respectively.
(2) Represents collateral on deposit as a percentage of the related debt outstanding.

Uses of Liquidity

Loan Advances

Loan advances are either from new loans approved to borrowers or from the unadvanced portion of loans previously approved. At May 31, 2011, unadvanced loan commitments totaled $14,071 million. Of that total at May 31, 2011, $999 million represented unadvanced commitments related to line of credit loans that are not subject to a material adverse change clause at the time of each loan advance. As such, we would be required to advance amounts on these committed facilities as long as the borrower is in compliance with the terms and conditions of the loan. New advances under 42 percent of these committed facilities would be advanced at CFC's standard rates and, therefore, any increase in CFC's costs to obtain funding required to make the advance could be passed on to the borrower. The remaining $13,072 million of unadvanced loan commitments at May 31, 2011 were generally subject to material adverse change clauses. Prior to making an advance on these facilities, we would confirm that there has been no material adverse change in the borrowers' business or financial condition since the time the loan was approved and confirm that the borrower is currently in compliance with loan terms and conditions.

Since we generally do not charge a fee for the borrower to have an unadvanced amount on a loan facility that is subject to a material adverse change clause, our borrowers tend to request amounts in excess of their immediate estimated loan requirements. It has been our history that we do not see significant loan advances from the large amount of long-term unadvanced loan amounts that are subject to material adverse change clauses at the time of the loan advance. We have a very low historical average utilization rate on all our line of credit unadvanced loans, including committed line of credit facilities. Unadvanced commitments related to line of credit loans are typically revolving facilities for periods not to exceed five years. Unadvanced commitments for long-term loans typically expire within five years of the first loan advance. The above items all contribute to our expectation that the majority of the unadvanced commitments reported will expire without being fully drawn upon and that the total commitment amount does not necessarily represent future cash funding requirements at May 31, 2011.

We currently expect to make long-term loan advances totaling approximately $870 million to our members over the next 12 months.

Interest Expense on Debt
For the year ended May 31, 2011, interest expense on debt was $820 million, representing an average cost of 4.42 percent compared with 4.71 percent and 4.81 percent for the years ended May 31, 2010 and 2009, respectively. For the past three fiscal years, interest expense on debt has averaged $875 million. At May 31, 2011, 79 percent of outstanding debt had a fixed interest rate and 21 percent had a variable interest rate.

Principal Repayments on Long-Term Debt
The principal amount and weighted average interest rates of medium-term notes, collateral trust bonds, long-term notes payable, subordinated deferrable debt and membership subordinated certificates maturing in each of the five fiscal years following May 31, 2011 and thereafter is as follows:

(dollar amounts in thousands)	Amount Maturing (1)	Weighted-Average Interest Rate
May 31, 2012	$ 2,522,554	5.04%
May 31, 2013	756,676	2.67
May 31, 2014	2,411,922	4.23
May 31, 2015	478,620	2.78
May 31, 2016	1,002,475	3.09
Thereafter	8,447,487	5.76
Total	$ 15,619,734	4.99

(1) Excludes loan subordinated certificates totaling $184 million that amortize annually based on the outstanding balance of the related loan. There are many items that affect the amortization of a loan, such as loan conversions, loan repricing at the end of an interest rate term and prepayments; therefore, an amortization schedule cannot be maintained for these certificates. Over the past three years, annual amortization on these certificates has averaged $23 million. In fiscal year 2011, amortization represented 16 percent of amortizing loan subordinated certificates outstanding.

Patronage Capital Retirements
CFC has made annual retirements of allocated net earnings in 31 of the last 32 years. In July 2011, the CFC Board of Directors approved the allocation of $92 million from fiscal year 2011 net earnings to CFC’s members. It is anticipated that CFC will make a cash payment of $46 to its members in September 2011 as retirement of 50 percent of allocated net earnings from the prior year as approved by CFC’s Board of Directors. The remaining portion of allocated net earnings will be retained by CFC for 25 years under guidelines adopted by CFC’s Board of Directors in June 2009.

Market Risk

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

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

We offer long-term loans to our rural electric system members with maturities of up to 35 years, and the weighted average maturity for our electric loan portfolio is currently about 17 years. We offer long-term loans to our telecommunication members with maturities of up to 10 years, and the weighted average maturity for our telecommunications loan portfolio is currently about six years. We also offer line of credit loans that are generally required to be paid down annually. We offer a variety of interest rate options on long-term loans including the ability to fix the interest rate for terms of one year through maturity. We fund the loan portfolio with a variety of debt instruments and our members' equity. We typically do not match fund each of our loans with a debt instrument of similar final maturity. Debt instruments such as membership subordinated certificates and loan and guarantee subordinated certificates have maturities that vary from the term of the associated loan or guarantee to 100 years; member capital securities have maturities of 35 years; and subordinated deferrable debt has been issued with maturities of up to 49 years. We may issue collateral trust bonds and medium-term notes for periods of up to 30 years, but typically issue such debt instruments with maturities of two, three, five, seven and 10 years. We face liquidity risk in the funding of our loan portfolio based on member demand for new loans, although as presented in our projected sources and uses of liquidity chart on page 57, we expect over the next six quarters, repayments on our long-term loans to exceed long-term loan advances by $1,092 million.

At May 31, 2011, we had $3,320 million of commercial paper, daily liquidity fund and bank bid notes scheduled to mature during the next 12 months. Based on past history, we expect to continue to maintain member investments in commercial paper and the daily liquidity fund at approximately the current level of $1,498 million at May 31, 2011, which represents an increase of $127 million from the balance at May 31, 2010. Dealer commercial paper and bank bid notes increased from $870 million at May 31, 2010 to $1,767 million at May 31, 2011. We expect the dealer commercial paper balance will fluctuate to offset changes in demand from our members. We intend to maintain the current level of commercial paper outstanding while favorable market conditions exist. We intend to limit the balance of dealer commercial paper and bank bid notes outstanding to 15 percent or less of total debt outstanding. At May 31, 2011, 15 percent of total debt outstanding was $2,869 million. In order to access the commercial paper markets at current levels, we believe we need to maintain our current ratings for commercial paper of P1 from Moody's Investors Service and A1 from Standard & Poor's Corporation.

We also limit dealer and member commercial paper to the amount of our bank lines of credit available to provide backup liquidity. At May 31, 2011, we had $3,545 million in available lines of credit with financial institutions. We expect to be in compliance with the covenants under our revolving credit agreements; therefore, we could draw on these facilities to repay any amount of dealer or member commercial paper that cannot be rolled over in the event of market disruptions. If we are unable to renew our $1,049 million five-year revolving credit agreement maturing in March 2012 at current commitment levels, it would reduce the amount of commercial paper funding we could obtain in the future.

At May 31, 2011, we had long-term debt maturing in the next 12 months totaling $2,523 million. In addition to our access to the dealer and member commercial paper markets as discussed above, we believe we will be able to refinance these maturing obligations because:

- Based on our funding sources available, we believe we will meet our obligations to pay down our medium-term notes sold through dealers of $1,987 million that mature over the next 12 months. This amount includes two notes totaling $1,750 million scheduled to mature in the third and fourth quarters of fiscal year 2012, $250 million of which was redeemed early on August 19, 2011.With the exception of these two notes with a remaining obligation of $1,500 million after the redemption, our funding requirement for term debt is limited during fiscal year 2012. Our loan volume is anticipated to decrease over the next 12 months; therefore, we do not expect that we will need to refinance the full amount of these notes. The remaining balance of dealer medium-term notes that mature over the next 12 months represents $237 million of retail notes. Based on past history when our retail notes outstanding balance reached $1,093 million in November 2009, as well as recent retail note issuances totaling $131 million during the year ended May 31, 2011, we believe such market funding is available to us on a supplemental basis.
- Based on past history, we expect to maintain the ability to roll over our medium-term notes sold to members of $266 million that mature over the next 12 months if we need this funding in the future.
- We expect to maintain the ability to obtain funding through the capital markets. During the year ended May 31, 2011, we issued $950 million of collateral trust bonds with interest rates ranging from 1.125 percent to 3.050 percent, maturing no longer than five years from the issuance date. In March 2011, we issued $250 million of nine-month floating-rate medium-term notes in a registered offering.
- We can borrow up to $3,900 million under a note purchase agreement with the Federal Agriculture Mortgage Corporation at any time through January 11, 2016, subject to market conditions for debt issued by the Federal Agricultural Mortgage Corporation. We have $2,489 million available under this revolving note purchase agreement through the filing date.
- 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. At May 31, 2011 and through the date of this filing, $350 million remains available under this facility.

- On April 15, 2011, the President of the United States signed the Full-Year Continuing Appropriations Act for Fiscal Year 2011, which provided an additional $500 million as part of the funding mechanism for the Rural Economic Development Loan and Grant program. CFC has submitted an application to RUS for the $500 million, 20-year maturity RUS-guaranteed Federal Financing Bank loan authorized under this program. This loan, if awarded to CFC, would be available for advances during the three-year period following the date of closing. The amount approved for CFC under this program by the federal government by its fiscal year ending September 30, 2011 could range between $0 to $500 million.

At May 31, 2011, we are the guarantor and liquidity provider for $524 million of tax-exempt bonds issued for our member cooperatives. During the year ended May 31, 2011, we were not required to purchase any tax-exempt bonds pursuant to our obligation as liquidity provider.

We expect that our $294 million of cash on hand and our current sources of liquidity at May 31, 2011 will allow us to issue the debt required to fund our operations over the next 12 to 18 months.

Interest Rate Risk

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

Matched Funding Practice

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

We fund the amount of fixed-rate assets that exceed fixed-rate debt and members' equity with short-term debt, primarily commercial paper. We also have the option to enter pay fixed-receive variable interest rate swaps. Our funding objective is to manage the matched funding of asset and liability repricing terms within a range of 5 percent of total assets excluding derivative assets. However, due to the flexibility we offer our borrowers, there is a possibility of significant changes in the composition of the fixed-rate loan portfolio, and the management of the interest rate gap is very fluid. We may use interest rate swaps to adjust the interest rate gap based on our needs for fixed-rate or variable-rate funding as changes arise. The interest rate risk is deemed minimal on variable-rate loans since the loans may be repriced either monthly or semi-monthly therefore minimizing the variance to the cost of variable-rate debt used to fund the loans. At May 31, 2011 and 2010, 14 percent and 19 percent, respectively, of loans carried variable interest rates.

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

The following table shows the scheduled amortization and repricing of fixed-rate assets and liabilities outstanding at May 31, 2011.

Interest Rate Gap Analysis
(Fixed-Rate Assets/Liabilities)
As of May 31, 2011

(dollar amounts in millions)	May 31, 2012 Or Prior	June 1, 2012 to May 31, 2014	June 1, 2014 to May 31, 2016	June 1, 2016 to May 31, 2021	June 1, 2021 to May 31, 2031	Beyond June 1, 2031	Total
Assets amortization and repricing (1)	$ 2,791	$ 4,310	$ 2,652	$ 3,462	$ 2,550	$ 841	$ 16,606
Liabilities and members' equity:							
Long-term debt	$1,909	$3,610	$ 2,410	$ 3,645	$ 699	$ 662	$12,935
Subordinated certificates	38	50	39	212	1,151	246	1,736
Members' equity (2)	-	-	-	39	237	397	673
Total liabilities and members' equity	$ 1,947	$ 3,660	$ 2,449	$ 3,896	$ 2,087	$ 1,305	$ 15,344
Gap (3)	$ 844	$ 650	$ 203	$ (434)	$ 463	$ (464)	$ 1,262
Cumulative gap	844	1,494	1,697	1,263	1,726	1,262	
Cumulative gap as a % of total assets	4.10%	7.27%	8.25%	6.14%	8.39%	6.14%	
Cumulative gap as a % of adjusted total assets (4)	4.17	7.39	8.39	6.25	8.54	6.24	

(1) Excludes fixed-rate loans on non-accrual status at May 31, 2011 totaling $434 million.
(2) Includes the portion of the loan loss allowance and subordinated deferrable debt allocated to fund fixed-rate assets and excludes non-cash adjustments from the accounting for derivative financial instruments.
(3) Assets less liabilities and members' equity.
(4) Adjusted total assets represent total assets in the consolidated balance sheet less derivative assets.

At May 31, 2011, we had $16,606 million of fixed-rate assets amortizing or repricing, funded by $12,935 million of fixed-rate liabilities maturing during the next 30 years and $2,409 million of members' equity and members' subordinated certificates, a portion of which does not have a scheduled maturity. The difference of $1,262 million, or 6.14 percent of total assets and 6.24 percent of total assets excluding derivative assets, represents the fixed-rate assets maturing during the next 30 years in excess of the fixed-rate debt and members'equity. We were slightly above our objective to manage our matched funding within a range of 5 percent at May 31, 2011 to allow the flexibility to maximize funding opportunities in the current low interest rate environment. In addition, we expect our long-term loan balance to decrease during fiscal year 2012. Funding fixed-rate loans with short-term debt presents a liquidity risk of being able to roll over the short-term debt until we issue term debt to fund the fixed-rate loans through their repricing or maturity date. Factors that mitigate this risk include our maintenance of backup liquidity through committed revolving credit agreements with domestic and foreign banks and a large volume of scheduled principal repayments we receive on an annual basis. Additionally, we can borrow up to $2,489 million available under our note purchase agreement with the Federal Agricultural Mortgage Corporation, subject to market conditions, and up to $350 million available under the committed loan facility from the Federal Financing Bank.

Derivative Financial Instruments
We are neither a dealer nor a trader in derivative financial instruments. We use derivatives such as interest rate swaps, treasury locks for forecasted transactions, cross-currency swaps and cross-currency interest rate swaps to mitigate interest rate and foreign currency exchange risk. These derivatives are used when they provide a lower cost of funding or minimize interest rate risk as part of our overall interest rate matching strategy. We have not entered into derivative financial instruments for trading purposes in the past and do not anticipate doing so in the future. At May 31, 2011 and 2010, there were no foreign currency derivative instruments outstanding.

We are required to record all derivative instruments in the consolidated balance sheets as either an asset or liability measured at fair value. Changes in the derivative instrument's fair value are required to be recognized currently in earnings unless specific hedge accounting criteria are met. Generally, our derivatives do not qualify for hedge accounting. A large portion of our interest rate exchange agreements use a LIBOR index or the 30-day composite commercial paper index as the receive leg, which has not been highly correlated to our own commercial paper rates to qualify for hedge accounting on a consistent basis. We believe that the LIBOR index or the 30-day composite commercial paper index are the rates that most closely relate to the rates we pay on our own commercial paper, and, therefore, we believe we are economically hedging our net interest income on loans with our interest rate exchange agreements. At May 31, 2011 and 2010, we did not have any interest rate exchange agreements that were accounted for using hedge accounting. Cash settlements that we pay and receive for derivative instruments that do not qualify for hedge accounting are recorded in the derivative losses line in the consolidated statements of operations.

The following table provides the notional amount, average interest rates and maturities by fiscal year for the interest rate exchange agreements to which we were a party at May 31, 2011.

(dollar amounts in millions)	Notional		Notional Amortization and Maturities					
		Fair						Remaining
Instruments	Amount	Value	2012	2013	2014	2015	2016	Years

Interest rate exchange agreements	$10,940	$(134)	$ 2,450	$ 1,635	$ 1,408	$ 863	$ 840	$ 3,744
Weighted-average pay rate	2.68%							
Weighted-average receive rate	2.71							

At May 31, 2011, 52 percent of our interest rate swaps were pay fixed-receive variable and 48 percent were pay variable-receive fixed. As a result, each 25 basis point increase or decrease to the 30-day composite commercial paper index and the one-month and three-month LIBOR rates would only result in a $0.8 million increase or decrease, respectively, in our net cash settlements. There were no cross currency or cross currency interest rate exchange agreements to which we were a party at May 31, 2011 and 2010.

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Other Financial Instruments

The table below provides information about our financial instruments other than derivatives that are sensitive to changes in interest rates. All of our financial instruments at May 31, 2011 were entered into or contracted for purposes other than trading except for the investments in preferred stock. For debt obligations, the table presents principal cash flows and related average interest rates by expected maturity dates at May 31, 2011.

(dollar amounts in millions)			Principal Amortization and Maturities					
Instrument	Outstanding Balance	Fair Value	2012	2013	2014	2015	2016	Remaining Years
Assets:								
Investments in equity securities	$ 59	$ 59	$ -	$ -	$ -	$ -	$ -	$ 59
Long-term fixed-rate loans (1)	16,563	17,284	1,058	1,020	891	831	821	11,942
Average rate	5.69%		5.45%	5.10 %	5.43 %	5.57 %	5.62%	5.80%
Long-term variable-rate loans (2)	$ 865	$ 865	$ 62	$ 267	$ 152	$ 36	$ 37	$ 311
Average rate (3)	4.87%		-	-	-	-	-	-
Line of credit loans (4)	$ 1,392	$ 1,392	$ 1,392	$ -	$ -	$ -	$ -	$ -
Average rate (3)	2.61%		2.61%	-	-	-	-	-
Non-performing loans (5)	$ 31	$ 11	$ 24	$ -	$ -	$ -	$ 1	$ 6
Average rate (5)	-		-	-	-	-	-	-
Restructured loans (5)	$ 474	$ 378	$ 13	$ 9	$ 10	$ 10	$ 10	$ 422
Average rate (5)	0.60%		-	-	-	-	-	-
Liabilities and equity:								
Short-term debt (6)	$ 5,843	$ 5,924	$ 5,843	$ -	$ -	$ -	$ -	$ -
Average rate	2.33%		2.33%	-	-	-	-	-
Medium-term notes	$ 1,403	$ 1,772	$ -	$ 110	$ 106	$ 60	$ 27	$ 1,100
Average rate	6.79%		-	2.89%	4.53%	2.65%	3.69%	7.70%
Collateral trust bonds	$ 5,508	$ 6,308	$ -	$ 255	$ 1,804	$ 5	$ 953	$ 2,491
Average rate	5.56%		-	2.72%	4.53%	7.35%	3.08%	7.54%
Long-term notes payable	$ 4,382	$ 4,621	$ -	$ 332	$ 470	$ 381	$ 6	$ 3,193
Average rate	3.57%		-	2.48%	3.03%	2.77%	4.22%	3.86%
Subordinated deferrable debt	$ 186	$ 188	$ -	$ -	$ -	$ -	$ -	$ 186
Average rate	6.02%		-	-	-	-	-	6.02%
Membership sub certificates (7)	$ 1,617	$ 1,777	$ -	$ 60	$ 31	$ 33	$ 16	$ 1,477
Average rate	5.16%		-	3.09%	3.61%	2.38%	2.21%	5.37%

(1) The principal amount of fixed-rate loans is the total of scheduled principal amortizations without consideration for loans that reprice. Includes $198 million of loans guaranteed by RUS.

(2) Long-term variable-rate loans include $28 million of loans guaranteed by RUS.

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

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

(5) Amortization based on current repayment schedule. All non-performing loans were on non-accrual status at May 31, 2011. Average rate on restructured loans represents current accrual rate. Interest accrual rate cannot be estimated for future periods.
(6) Short-term debt includes commercial paper, bank bid notes and long-term debt due in less than one year.
(7) Carrying value and fair value exclude loan subordinated certificates totaling $184 million that amortize annually based on the outstanding balance of the related loan; therefore, there is no scheduled amortization. Over the past three years, annual amortization on these certificates has averaged $23 million. In fiscal year 2011, amortization represented 16 percent of amortizing loan subordinated certificates outstanding.

Counterparty Risk

We are exposed to counterparty risk related to the performance of the parties with which we entered into derivative instruments. To mitigate this risk, we only enter into these agreements with financial institutions with investment-grade ratings. At May 31, 2011 and 2010, the highest percentage concentration of total notional exposure to any one counterparty was 13 percent and 12 percent of total derivative instruments, respectively. At the time counterparties are selected to participate in our exchange agreements, the counterparty must be a participant in one of our revolving credit agreements. In addition, the derivative instruments executed for each counterparty are based on key characteristics such as the following: notional concentration, credit risk exposure, tenor, bid success rate, total credit commitment and credit ratings. At the date of this filing, our derivative instrument counterparties had credit ratings ranging from AAA to BBB+ as assigned by Standard & Poor’s Corporation and Aaa to Baa1 as assigned by Moody’s Investors Service. Based on the fair market value of our derivative instruments at May 31, 2011, there were five counterparties that would be required to make a payment to us totaling $62 million if all of our derivative instruments were terminated on that day. The largest amount owed to us by a single counterparty was $28 million, or 46 percent of the total exposure to us, at May 31, 2011.

Rating Triggers

Some of our interest rate swaps have credit risk-related contingent features referred to as rating triggers. Rating triggers are not separate financial instruments and are not required to be accounted for separately as derivatives.

At May 31, 2011, the following notional amounts of derivative instruments had rating triggers based on our senior unsecured credit ratings from Moody's Investors Service or Standard & Poor's Corporation falling to a level specified in the applicable agreements and are grouped into the categories below. In calculating the payments and collections required upon termination, we netted the agreements for each counterparty, as allowed by the underlying master agreements. At May 31, 2011, our senior unsecured credit rating from Moody's Investors Service and Standard & Poor's Corporation was A2 and A, respectively. At May 31, 2011, 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)	$ 1,373,633}	$ (440)	$ 28,433}	$ 27,993}
fall below Baa1/BBB+ (1)	6,753,582}	(113,627)	27,470}	(86,157)
Total	$ 8,127,215}	$ (114,067)	$ 55,903}	$ (58,164)

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

In addition to the rating triggers listed above, at May 31, 2011, we had a total notional amount of $868 million of derivative instruments with one counterparty that would require the pledging of collateral totaling $20 million (the fair value of such derivative instruments excluding credit risk) if our senior unsecured ratings from Moody's Investors Service were to fall below Baa2 or if our ratings from Standard & Poor's Corporation were to fall below BBB. The aggregate fair value of all interest rate swaps with rating triggers that were in a net liability position at May 31, 2011 was $132 million.

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

Non-GAAP Financial Measures

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

Adjustments to Net Income and the Calculation of TIER

Our primary performance measure is TIER. TIER is calculated by adding the interest expense to net income prior to the cumulative effect of change in accounting principle and dividing that total by the interest expense. TIER is a measure of our ability to cover interest expense requirements on our debt. We adjust the TIER calculation to add the derivative cash settlements to the interest expense and to remove the derivative forward value and foreign currency adjustments from total net income. Adding the cash settlements back to the interest expense also has a corresponding effect on our adjusted net interest income. We make these adjustments to our TIER calculation for covenant compliance on our revolving credit agreements. The revolving credit agreements require us to achieve an average adjusted TIER over the six most recent fiscal quarters of at least 1.025 and prohibit the retirement of patronage capital unless we have achieved an adjusted TIER of at least 1.05 for the preceding fiscal year.

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

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

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

The following table provides a reconciliation between interest expense and net interest income, and these financial measures adjusted to include the impact of derivatives. Additionally, it provides a reconciliation of net income and this financial measure adjusted to exclude the impact of derivatives and foreign currency adjustments for the five years ended May 31:

(dollar amounts in thousands)	2011	2010	2009	2008	2007
Interest expense	$ (841,080)	$ (912,111)	$ (935,021)	$ (931,268)	$ (991,754)
Derivative cash settlements	(6,848)	(23,304)	112,989	27,033	86,442
Adjusted interest expense	$ (847,928)	$ (935,415)	$ (822,032)	$ (904,235)	$ (905,312)
Net interest income	$ 167,831}	$ 131,524	$ 135,743	$ 120,125	$ 47,896
Derivative cash settlements	(6,848)	(23,304)	112,989	27,033	86,442
Adjusted net interest income	$ 160,983}	$ 108,220	$ 248,732	$ 147,158	$ 134,338
Net income (loss) prior to cumulative effect of change in accounting principle	$ 151,215}	$ 110,547	$ (73,770)	$ 39,646	$ 14,145
Derivative forward value	23,388}	(2,696)	160,017	98,743	79,281
Foreign currency adjustments	-}	-	-	-	14,554
Adjusted net income	$ 174,603}	$ 107,851	$ 86,247	$ 138,389	$ 107,980

TIER using GAAP financial measures is calculated as follows:

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

Our adjusted TIER is calculated as follows:

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

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

	2011	2010	2009	2008	2007
TIER (1)	1.18}	1.12	-	1.04	1.01
Adjusted TIER					