NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORP /DC/
Form 10-Q
April 14, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended February 28, 2014

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____to ______

Commission File Number 1-7102

NATIONAL RURAL UTILITIES COOPERATIVE

FINANCE CORPORATION

(Exact name of registrant as specified in its charter)

District of Columbia	**52-0891669**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. employer identification no.)**
20701 Cooperative Way, Dulles, Virginia	**20166**
(Address of principal executive offices)	**(Zip Code)**

Registrant's telephone number, including area code: (703) 467-1800

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

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

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 Exchange Act). Yes ¨ No **x**

The Registrant does not issue capital stock because it is a tax-exempt cooperative.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

ASSETS

(Dollars in thousands)	February 28, 2014	May 31, 2013
Cash and cash equivalents	$ **842,915**	$ 177,062
Restricted cash	7,256	7,696
Investments	28,702	31,632
Time deposits	700,000	700,000
Loans to members	20,645,064	20,305,874
Less: Allowance for loan losses	(56,040)	(54,325)
Loans to members, net	20,589,024	20,251,549
Accrued interest and other receivables	207,894	175,183
Fixed assets, net	106,267	104,508
Debt service reserve funds	39,353	39,803
Debt issuance costs, net	43,325	38,949
Foreclosed assets, net	255,150	261,472
Derivative assets	261,598	257,878
Other assets	25,845	25,919
Total assets	$ **23,107,329**	$ 22,071,651

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

LIABILITIES AND EQUITY

(Dollars in thousands)	February 28, 2014	May 31, 2013
Short-term debt	$ **6,541,987**	$ 7,719,483
Accrued interest payable	203,085	144,945
Long-term debt	12,902,920	10,696,433
Deferred income	79,670	25,717
Derivative liabilities	380,518	475,278
Subordinated deferrable debt	400,000	400,000
Members' subordinated certificates:		
Membership subordinated certificates	644,757	644,757
Loan and guarantee subordinated certificates	668,918	696,719
Member capital securities	173,290	387,750
Total members' subordinated certificates	1,486,965	1,729,226
Other liabilities	121,894	69,308
Commitments and contingencies		
Total liabilities	22,117,039	21,260,390
CFC equity:		
Retained equity	958,620	791,090
Accumulated other comprehensive income	4,723	8,381
Total CFC equity	963,343	799,471
Noncontrolling interest	26,947	11,790
Total equity	990,290	811,261
Total liabilities and equity	**$ 23,107,329**	$ 22,071,651

See accompanying notes.

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NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	Three Months Ended February 28,		Nine Months Ended February 28,	
(Dollars in thousands)	2014	2013	2014	2013
Interest income	$238,732	$234,021	$719,057	$715,736
Interest expense	(163,534)	(171,899)	(496,464)	(522,796)
Net interest income	75,198	62,122	222,593	192,940
(Provision for) recovery of loan losses	(787)	378	(3,161)	(4,927)
Net interest income after (provision for) recovery of loan losses	74,411	62,500	219,432	188,013
Non-interest income:				
Fee and other income	5,702	6,337	14,983	29,102
Derivative (losses) gains, net	(31,623)	46,626	43,981	18,268
Results of operations of foreclosed assets	(1,164)	6,478	(8,482)	804
Total non-interest income	(27,085)	59,441	50,482	48,174
Non-interest expense:				
Salaries and employee benefits	(8,013)	(23,627)	(27,359)	(44,180)
Other general and administrative expenses	(9,170)	(6,652)	(27,012)	(22,720)
(Provision for) recovery of guarantee liability	(117)	46	(159)	147
Losses on early extinguishment of debt	(1,452)	-	(1,452)	-
Other	210	(554)	(88)	(5,101)
Total non-interest expense	(18,542)	(30,787)	(56,070)	(71,854)
Income prior to income taxes	28,784	91,154	213,844	164,333
Income tax expense	(243)	(1,067)	(2,045)	(1,519)
Net income	28,541	90,087	211,799	162,814
Less: Net income attributable to noncontrolling interest	(239)	(1,664)	(3,024)	(2,368)
Net income attributable to CFC	$28,302	$88,423	$208,775	$160,446

See accompanying notes.

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NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

(Dollars in thousands)	Three Months Ended February 28, 2014	2013	Nine Months Ended February 28, 2014	2013
Net income	$28,541	$90,087	$211,799	$162,814
Other comprehensive income (loss):				
Add: Unrealized gains (losses) on available-for-sale securities	2,313	(479)	(2,931)	408
Less: Net derivative gains reclassified into earnings	(245)	(251)	(740)	(756)
Other comprehensive income (loss)	2,068	(730)	(3,671)	(348)
Total comprehensive income	30,609	89,357	208,128	162,466
Less: Total comprehensive income attributable to noncontrolling interest	(235)	(1,659)	(3,011)	(2,352)
Total comprehensive income attributable to CFC	$30,374	$87,698	$205,117	$160,114

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(UNAUDITED)

(Dollars in thousands)	Membership Fees and Education Fund	Patronage Capital Allocated	Members' Capital Reserve	Unallocated Net Income (Loss)	CFC Retained Equity	Accumulated Other Comprehensive Income	Total CFC Equity	Noncontrolling Interest	Total Equity
Balance as of May 31, 2013	$2,505	$591,581	$410,259	$(213,255)	791,090	$8,381	$799,471	$11,790	$811,261
Patronage capital retirement	-	(40,724)	-	-	(40,724)	-	(40,724)	-	(40,724)
Net income	-	-	-	208,775	208,775	-	208,775	3,024	211,799
Other comprehensive loss	-	-	-	-	-	(3,658)	(3,658)	(13)	(3,671)
Other	(521)	-	-	-	(521)	-	(521)	12,146	11,625
Balance as of February 28, 2014	$1,984	$550,857	$410,259	$(4,480)	958,620	$4,723	$963,343	$26,947	$990,290
Balance as of May 31, 2012	$2,413	$546,366	$272,126	$(346,941)	473,964	$9,199	$483,163	$7,592	$490,755
Patronage capital retirement	-	(36,075)	-	429	(35,646)	-	(35,646)	-	(35,646)
Net income	-	-	-	160,446	160,446	-	160,446	2,368	162,814
Other comprehensive loss	-	-	-	-	-	(332)	(332)	(16)	(348)
Other	(539)	-	-	-	(539)	-	(539)	(1)	(540)
Balance as of February 28, 2013	$1,874	$510,291	$272,126	$(186,066)	598,225	$8,867	$607,092	$9,943	$617,035

See accompanying notes.

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NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Nine Months Ended February 28,	
(Dollars in thousands)	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$211,799	$162,814
Adjustments to reconcile net income to net cash provided by operating activities		
Amortization of deferred income	(7,156)	(6,879)
Amortization of debt issuance costs and deferred charges	5,393	5,733
Amortization of discount on long-term debt	4,046	2,953
Amortization of issuance costs on revolving bank lines of credit	2,098	2,159
Depreciation	4,254	3,984
Provision for loan losses	3,161	4,927
Provision for (recovery of) guarantee liability	159	(147)
Results of operations of foreclosed assets	8,482	(804)
Derivative forward value	(98,925)	(62,194)
Net changes in operating assets and liabilities:		
Accrued interest and other receivables	(37,792)	27,948
Accounts payable	67,489	17,635
Accrued interest payable	58,140	50,688
Deferred income	61,109	666
Other	(1,116)	(5,183)
Net cash provided by operating activities	281,141	204,300
CASH FLOWS FROM INVESTING ACTIVITIES		
Advances made on loans	(6,165,888)	(6,021,056)
Principal collected on loans	5,825,426	5,455,065
Net investment in fixed assets	(6,004)	(4,648)
Proceeds from foreclosed assets	-	46,284
Investments in foreclosed assets	(2,160)	(79,372)
Investments in time deposits	-	(450,000)
Proceeds from early redemption of investments	-	57,578
Investments in equity securities	-	(30,000)
Change in restricted cash	440	475
Net cash used in investing activities	(348,186)	(1,025,674)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuances of short-term debt, net	762,205	686,383
Proceeds from issuances of short term debt with original maturity greater than 90 days	593,401	370,949

Repayments of short term debt with original maturity greater than 90 days	(620,404)	(394,366)
Issuance costs for revolving bank lines of credit	-	(50)
Proceeds from issuance of long-term debt	2,449,067	1,945,944
Payments for redemption of long-term debt	(2,368,220)	(1,062,956)
Proceeds from issuance of members' subordinated certificates	56,386	57,166
Payments for retirement of members' subordinated certificates	(99,507)	(15,358)
Payments for retirement of patronage capital	(40,030)	(34,872)
Cash paid portion of debt exchange premium	-	(133,406)
Net cash provided by financing activities	732,898	1,419,434
NET INCREASE IN CASH AND CASH EQUIVALENTS	665,853	598,060
BEGINNING CASH AND CASH EQUIVALENTS	177,062	191,167
ENDING CASH AND CASH EQUIVALENTS	**$842,915**	$789,227

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Nine Months Ended February 28,	
(Dollars in thousands)	2014	2013
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid for:		
Interest	$426,755	$461,263
Income taxes	157	97
Non-cash financing and investing activities:		
Net decrease in debt service reserve funds/debt service reserve certificates	(450)	-
Collateral trust bonds issued as debt exchange premium	-	39,647

See accompanying notes.

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NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

(1) Summary of Significant Accounting Policies

(a) Basis of Presentation

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

Unless stated otherwise, references to “we,” “our” or “us” represent the consolidation of CFC, RTFC, NCSC and certain entities created and controlled by CFC to hold foreclosed assets and accommodate loan securitization transactions. Foreclosed assets are held by two subsidiaries controlled by CFC. Denton Realty Partners, LP (“DRP”) holds a land development loan and a related limited partnership interest. Caribbean Asset Holdings (“CAH”) holds our investment in cable and telecommunications operating entities in the United States Virgin Islands (“USVI”), British Virgin Islands and St. Maarten.

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

During the preparation of our consolidated balance sheets for the quarter ended February 28, 2014, we determined that an intercompany elimination entry related to the consolidation of RTFC had been misclassified in each period since May 31, 2009, resulting in an overstatement of other liabilities and an understatement of noncontrolling interest at the end of each reported period. We corrected the misclassification in the quarter ended February 28, 2014, which resulted in a decrease of $11.5 million in other liabilities and a corresponding increase in noncontrolling interest. We concluded that the correction of the misclassification was not material to our financial position in the current period, and the misclassification was not material to our financial position in the previously reported periods. Accordingly, we did not revise prior period balance sheet amounts. The misclassification had no impact on our consolidated statements of operations and comprehensive income, total assets, total liabilities and equity, or cash flows for any of our previously filed annual or quarterly financial statements, and did not impact the compliance with any of our financial debt covenants for any period.

These interim unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended May 31, 2013. Reclassifications of prior period amounts have been made to conform to the current period presentation.

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

(b) Variable Interest Entities

We are required to consolidate the financial results of RTFC and NCSC because CFC is the primary beneficiary of variable interests in RTFC and NCSC due to its exposure to absorbing the majority of their expected losses and because CFC manages the lending activities of RTFC and NCSC.

Under separate guarantee agreements, RTFC and NCSC pay CFC a fee to indemnify against loan losses. CFC is the sole lender to and manages the business operations of RTFC through a management agreement in effect until December 1, 2016, which is automatically renewed for one-year terms thereafter unless terminated by either party. CFC is the primary source of funding to and manages the lending activities of NCSC through a management agreement that is automatically renewable on an annual basis unless terminated by either party. NCSC funds its lending programs through loans from CFC or debt guaranteed by CFC. In connection with these guarantees, NCSC must pay a guarantee fee and purchase from CFC interest-bearing subordinated term certificates in proportion to the related guarantee.

RTFC and NCSC creditors have no recourse against CFC in the event of a default by RTFC and NCSC, unless there is a guarantee agreement under which CFC has guaranteed NCSC or RTFC debt obligations to a third party. At February 28, 2014, CFC had guaranteed $121 million of NCSC debt, derivative instruments and guarantees with third parties, and CFC’s maximum potential exposure for these instruments totaled $128 million. The maturities for NCSC obligations guaranteed by CFC extend through 2031. Guarantees of NCSC debt and derivative instruments are not included in Note 10, *Guarantees,* as the debt and derivatives are reported on the condensed consolidated balance sheet. At February 28, 2014, CFC guaranteed $2 million of RTFC guarantees with third parties. The maturities for RTFC obligations guaranteed by CFC extend through 2015 and are renewed on an annual basis. All CFC loans to RTFC and NCSC are secured by all assets and revenue of RTFC and NCSC, respectively. At February 28, 2014, RTFC had total assets of $577 million including loans outstanding to members of $455 million, and NCSC had total assets of $804 million including loans outstanding of $779 million. At February 28, 2014, CFC had committed to lend RTFC up to $4,000 million, of which $441 million was outstanding. At February 28, 2014, CFC had committed to provide up to $3,000 million of credit to NCSC, of which $884 million was outstanding, representing $763 million of outstanding loans and $121 million of credit enhancements.

(c) Loan Sales

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

During the nine months ended February 28, 2014 and 2013, we sold CFC loans with outstanding balances totaling $106 million and $121 million, respectively, at par for cash. We recorded immaterial losses on the sale of these loans.

(d) Interest Income

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

	Three Months Ended February 28,		Nine Months Ended February 28,	
(Dollars in thousands)	2014	2013	2014	2013
Interest on long-term fixed-rate loans	$220,227	$216,716	$666,762	$652,903
Interest on long-term variable-rate loans	5,217	5,203	14,871	16,121

Interest on line of credit loans	8,302	7,961	23,379	23,066
Interest on restructured loans	-	436	136	13,523
Interest on investments	1,932	1,864	5,685	4,378
Fee income (1)	3,054	1,841	8,224	5,745
Total interest income	$238,732	$234,021	$719,057	$715,736

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

Deferred income recorded on the condensed consolidated balance sheets primarily consists of deferred conversion fees totaling $74 million and $21 million at February 28, 2014 and May 31, 2013, respectively.

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(e) Interest Expense

The following table presents the components of interest expense:

	Three Months Ended February 28,		Nine Months Ended February 28,	
(Dollars in thousands)	2014	2013	2014	2013
Interest expense on debt (1):				
Short-term debt	$1,406	$1,717	$4,445	$5,033
Medium-term notes	20,369	21,294	62,920	74,010
Collateral trust bonds	76,090	84,197	227,746	247,907
Subordinated deferrable debt	4,750	2,806	14,250	8,419
Subordinated certificates	19,777	20,345	60,897	61,227
Long-term notes payable	37,130	37,622	113,828	113,933
Debt issuance costs (2)	1,806	1,891	5,453	5,733
Fee expense (3)	2,206	2,027	6,925	6,534
Total interest expense	$163,534	$171,899	$496,464	$522,796

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

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

(3) Includes various fees related to funding activities, including fees paid to banks participating in our revolving credit agreements.

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

(f) Derivative Financial Instruments

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

We formally document, designate and assess the effectiveness of derivatives designated for hedge accounting treatment, which typically include treasury rate locks. If applicable cash flow hedge accounting criteria are met for these derivatives, changes in the fair value of the derivative instruments are recorded in other comprehensive income, and net cash settlements are recorded in interest expense. The gain or loss on derivatives used as a cash flow hedge of a forecasted debt transaction is recorded as a component of other comprehensive income (loss) and reclassified to interest expense using the effective interest method over the term of the hedged debt. Any ineffectiveness in the hedging relationship is recognized in the derivative gains (losses) line of the statement of operations.

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

(g)New Accounting Pronouncements

In December 2011, the Financial Accounting Standards Board issued Accounting Standards Update, *Disclosures about Offsetting Assets and Liabilities,* which requires enhanced disclosures about certain financial assets and liabilities that are subject to enforceable master netting agreements or similar agreements, or that have otherwise been offset on the balance sheet under certain specific conditions that permit net presentation. In January 2013, the Financial Accounting Standards Board issued Accounting Standards Update, *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities,* which clarifies that the scope of the above guidance is limited to derivatives, repurchase and reverse repurchase agreements,

and securities borrowing and lending transactions. The guidance was effective for us beginning in the first quarter of fiscal year 2014. See Note 8, *Derivative Financial Instruments*, for additional disclosures about offsetting assets and liabilities.

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update, *Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income*, which requires enhanced disclosures of the amounts reclassified out of Accumulated Other Comprehensive Income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of Accumulated Other Comprehensive Income by the respective line items of net income, but only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. The guidance was effective for us beginning in the first quarter of fiscal year 2014 and did not have a material effect on the condensed consolidated financial statements, as the amounts reclassified out of other comprehensive income are immaterial for all periods presented.

(2) Investment Securities

Our investment securities consist of Federal Agricultural Mortgage Corporation Series A preferred stock with a cost basis of $30 million and fair value of $27 million and $29 million at February 28, 2014 and May 31, 2013, respectively, and an unrealized loss of $3 million and $1 million, respectively, recorded in accumulated other comprehensive income on the condensed consolidated balance sheet. The investment has been in a continuous unrealized loss position for less than twelve months, primarily due to the increase in interest rates. We do not intend to sell this investment in the foreseeable future and we currently expect to fully recover our cost. Our investment in this Series A preferred stock is classified as available-for-sale and therefore recorded in the condensed consolidated balance sheets at fair value.

Our investments also include Federal Agricultural Mortgage Corporation Class A common stock with a cost basis of $0.5 million and a fair value of $2.1 million and $2.2 million at February 28, 2014 and May 31, 2013, respectively, and an unrealized gain of $1.6 million and $1.7 million, respectively, recorded in accumulated other comprehensive income on the condensed consolidated balance sheet. Our investment in this Class A common stock is classified as available-for-sale and therefore recorded in the condensed consolidated balance sheets at fair value.

(3) Loans and Commitments

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

	February 28, 2014		May 31, 2013	
(Dollars in thousands)	Loans Outstanding	Unadvanced Commitments (1)	Loans Outstanding	Unadvanced Commitments (1)
Total by loan type (2):				
Long-term fixed-rate loans	$18,185,111	$ -	$17,918,268	$ -
Long-term variable-rate loans	770,883	4,547,813	782,006	4,718,162
Loans guaranteed by RUS	203,173	-	210,815	-
Line of credit loans	1,476,166	8,996,845	1,385,228	8,704,586
Total loans outstanding	20,635,333	13,544,658	20,296,317	13,422,748

Deferred origination costs	9,731	-	9,557	-
Less: Allowance for loan losses	(56,040)	-	(54,325)	-
Net loans outstanding	$20,589,024	$ 13,544,658	$20,251,549	$ 13,422,748
Total by member class (2):				
CFC:				
Distribution	$15,186,620	$ 9,115,128	$14,941,192	$ 8,948,826
Power supply	4,149,104	3,024,666	4,007,669	3,145,518
Statewide and associate	64,822	128,440	70,956	102,087
CFC total	19,400,546	12,268,234	19,019,817	12,196,431
RTFC	455,492	312,466	503,359	317,344
NCSC	779,295	963,958	773,141	908,973
Total loans outstanding	$20,635,333	$ 13,544,658	$20,296,317	$ 13,422,748

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

(2) Includes nonperforming and restructured loans.

Nonperforming and restructured loans outstanding and unadvanced commitments to members included in the table above are summarized by loan type and by company below:

	February 28, 2014		May 31, 2013	
(Dollars in thousands)	Loans Outstanding	Unadvanced Commitments (1)	Loans Outstanding	Unadvanced Commitments (1)
Nonperforming and restructured loans:				
Nonperforming loans:				
CFC:				
Line of credit loans	$ 5,000	$ -	$ 5,000	$ -
NCSC:				
Line of credit loans	450	-	-	-
RTFC:				
Long-term fixed-rate loans	2,786	-	3,690	-
Long-term variable-rate loans	2,609	-	6,807	-
Total nonperforming loans	$ 10,845	$ -	$ 15,497	$ -
Restructured loans:				
CFC:				
Long-term fixed-rate loans	$ 7,584	$ -	$ 46,953	$ -
Line of credit loans (2)	-	-	-	5,000
Total restructured loans	$ 7,584	$ -	$ 46,953	$ 5,000

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

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

Unadvanced Loan Commitments

A total of $2,249 million and $1,703 million of unadvanced commitments at February 28, 2014 and May 31, 2013, respectively, represented unadvanced commitments related to committed lines of credit loans that are not subject to a material adverse change clause at the time of each loan advance. As such, we will be required to advance amounts on these committed facilities as long as the borrower is in compliance with the terms and conditions of the facility.

The following table summarizes the available balance at February 28, 2014 under committed lines of credit that are not subject to a material adverse change clause and the related maturities by fiscal year and thereafter as follows:

	Available	Notional Maturities of Committed Lines of Credit					
(Dollars in thousands)	Balance	2014	2015	2016	2017	2018	Thereafter
Committed lines of credit	$2,248,762	$19,048	$55,026	$61,000	$466,061	$861,098	$786,529

The remaining unadvanced commitments totaling $11,296 million and $11,720 million at February 28, 2014 and May 31, 2013, respectively, were generally subject to material adverse change clauses. Prior to making an advance on these facilities, we confirm that there has been no material adverse change in the business or condition, financial or otherwise, of the borrower since the time the loan was approved and confirm that the borrower is currently in compliance with loan terms and conditions. In some cases, the borrower's access to the full amount of the facility is further constrained by the imposition of borrower-specific restrictions, or by additional conditions that must be met prior to advancing funds.

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

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

Payment Status of Loans

The tables below present the payment status, including an aging of delinquent loans, of the recorded investment in loans outstanding by member class at February 28, 2014 and May 31, 2013:

	February 28, 2014					
(Dollars in thousands)	Current	30-89 Days Past Due	90 Days or More Past Due (1)	Total Past Due	Total Financing Receivables	Non-accrual Loans
CFC:						
Distribution	$ 15,186,620	$ -	$ -	$ -	$ 15,186,620	$ 7,584
Power supply	4,144,104	-	5,000	5,000	4,149,104	5,000
Statewide and associate	64,822	-	-	-	64,822	-
CFC total	19,395,546	-	5,000	5,000	19,400,546	12,584
RTFC	451,913	-	3,579	3,579	455,492	5,395
NCSC	779,295	-	-	-	779,295	450
Total loans outstanding	$ 20,626,754	$ -	$ 8,579	$ 8,579	$ 20,635,333	$ 18,429
As a % of total loans	99.96 %	0.00 %	0.04 %	0.04 %	100.00 %	0.09 %

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

	May 31, 2013					
(Dollars in thousands)	Current	30-89 Days Past Due	90 Days or More Past Due (1)	Total Past Due	Total Financing Receivables	Non-accrual Loans
CFC:						
Distribution	$ 14,938,351	$ 2,841	$ -	$ 2,841	$ 14,941,192	$ 7,584
Power supply	4,002,669	-	5,000	5,000	4,007,669	5,000
Statewide and associate	70,956	-	-	-	70,956	-
CFC total	19,011,976	2,841	5,000	7,841	19,019,817	12,584
RTFC	495,040	4,163	4,156	8,319	503,359	10,497
NCSC	773,141	-	-	-	773,141	-
Total loans outstanding	$ 20,280,157	$ 7,004	$ 9,156	$ 16,160	$ 20,296,317	$ 23,081
As a % of total loans	99.92 %	0.03 %	0.05 %	0.08 %	100.00 %	0.11 %

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

Credit Quality

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

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

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

(i) Pass: Borrowers that are not experiencing difficulty and/or not showing a potential or well-defined credit weakness.

(ii) Criticized: Includes borrowers categorized as special mention, substandard and doubtful as described below:

- Special mention: Borrowers that may be characterized by a potential credit weakness or deteriorating financial condition that is not sufficiently serious to warrant a classification of substandard or doubtful.
- Substandard: Borrowers that display a well-defined credit weakness that may jeopardize the full collection of principal and interest.
- Doubtful: Borrowers that have a well-defined weakness and the full collection of principal and interest is questionable or improbable.

Borrowers included in the pass, special mention, and substandard categories are reflected in the general portfolio of loans. Borrowers included in the doubtful category are reflected in the impaired portfolio of loans. Each risk rating is reassessed annually based on the receipt of the borrower's audited financial statements; however, interim downgrades and upgrades may take place at any time as significant events or trends occur.

The following table presents our loan portfolio by risk rating category and member class at February 28, 2014 and May 31, 2013:

	February 28, 2014			May 31, 2013		
(Dollars in thousands)	Pass	Criticized	Total	Pass	Criticized	Total
CFC:						
Distribution	$15,168,785	$17,835	$15,186,620	$14,922,558	$18,634	$14,941,192
Power supply	4,144,104	5,000	4,149,104	4,002,669	5,000	4,007,669
Statewide and associate	64,542	280	64,822	70,668	288	70,956
CFC total	19,377,431	23,115	19,400,546	18,995,895	23,922	19,019,817
RTFC	441,757	13,735	455,492	483,058	20,301	503,359
NCSC	776,981	2,314	779,295	770,419	2,722	773,141
Total loans outstanding	$20,596,169	$39,164	$20,635,333	$20,249,372	$46,945	$20,296,317

Loan Security

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

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

	February 28, 2014				May 31, 2013			
(Dollars in thousands)	Secured	%	Unsecured	%	Secured	%	Unsecured	%
Total by loan type:								
Long-term fixed-rate loans	$17,128,504	94 %	$1,056,607	6 %	$16,871,594	94 %	$1,046,674	6 %
Long-term variable-rate loans	679,446	88	91,437	12	676,075	86	105,931	14
Loans guaranteed by RUS	203,173	100	-	-	210,815	100	-	-
Line of credit loans	307,820	21	1,168,346	79	294,575	21	1,090,653	79
Total loans outstanding	$18,318,943	89	$2,316,390	11	$18,053,059	89	$2,243,258	11
Total by company:								
CFC	$17,323,741	89 %	$2,076,805	11%	$17,049,029	90 %	$1,970,788	10%
RTFC	436,001	96	19,491	4	482,647	96	20,712	4
NCSC	559,201	72	220,094	28	521,383	67	251,758	33
Total loans outstanding	$18,318,943	89	$2,316,390	11	$18,053,059	89	$2,243,258	11

Loan Loss Allowance

We maintain an allowance for loan losses at a level estimated by management to provide for probable losses inherent in the loan portfolio. The tables below summarize the changes in the allowance for loan losses by company for the three and nine months ended February 28, 2014.

	Three Months Ended February 28, 2014			
(Dollars in thousands)	CFC	RTFC	NCSC	Total
Balance as of November 30, 2013	$42,762	$7,859	$4,578	$55,199
Provision for (recovery of) loan losses	1,543	(2,450)	1,694	787
Charge-offs	-	-	-	-
Recoveries of loans previously charged-off	54	-	-	54
Balance as of February 28, 2014	$44,359	$5,409	$6,272	$56,040

	Three Months Ended February 28, 2013			
(Dollars in thousands)	CFC	RTFC	NCSC	Total
Balance as of November 30, 2012	$133,578	$8,314	$6,845	$148,737
Provision for (recovery of) loan losses	432	(214)	(596)	(378)
Recoveries of loans previously charged-off	52	-	-	52
Balance as of February 28, 2013	$134,062	$8,100	$6,249	$148,411

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	Nine Months Ended February 28, 2014			
(Dollars in thousands)	CFC	RTFC	NCSC	Total
Balance as of May 31, 2013	$41,246	$9,158	$3,921	$54,325
Provision for (recovery of) loan losses	2,953	(2,143)	2,351	3,161
Charge-offs	-	(1,606)	-	(1,606)
Recoveries of loans previously charged-off	160	-	-	160
Balance as of February 28, 2014	$44,359	$5,409	$6,272	$56,040

	Nine Months Ended February 28, 2013			
(Dollars in thousands)	CFC	RTFC	NCSC	Total
Balance as of May 31, 2012	$126,941	$8,562	$7,823	$143,326
Provision for (recovery of) loan losses	6,963	(462)	(1,574)	4,927
Recoveries of loans previously charged-off	158	-	-	158
Balance as of February 28, 2013	$134,062	$8,100	$6,249	$148,411

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

	February 28, 2014			
(Dollars in thousands)	CFC	RTFC	NCSC	Total
Ending balance of the allowance:				
Collectively evaluated	$44,359	$4,950	$6,217	$55,526
Individually evaluated	-	459	55	514
Total ending balance of the allowance	$44,359	$5,409	$6,272	$56,040
Recorded investment in loans:				
Collectively evaluated	$19,387,962	$450,097	$778,845	$20,616,904
Individually evaluated	12,584	5,395	450	18,429
Total recorded investment in loans (1)	$19,400,546	$455,492	$779,295	$20,635,333
Loans to members, net (1)	$19,356,187	$450,083	$773,023	$20,579,293

	May 31, 2013			
(Dollars in thousands)	CFC	RTFC	NCSC	Total
Ending balance of the allowance:				
Collectively evaluated	$41,246	$5,731	$3,921	$50,898
Individually evaluated	-	3,427	-	3,427
Total ending balance of the allowance	$41,246	$9,158	$3,921	$54,325

Recorded investment in loans:				
Collectively evaluated	$18,967,864	$492,862	$773,141	$20,233,867
Individually evaluated	51,953	10,497	-	62,450
Total recorded investment in loans (1)	$19,019,817	$503,359	$773,141	$20,296,317
Loans to members, net (1)	$18,978,571	$494,201	$769,220	$20,241,992

(1) Excludes deferred origination costs of $10 million at February 28, 2014 and May 31, 2013.

Impaired Loans

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

(Dollars in thousands)	February 28, 2014 Recorded Investment	February 28, 2014 Related Allowance	May 31, 2013 Recorded Investment	May 31, 2013 Related Allowance
With no specific allowance recorded:				
CFC/Distribution	$7,584	$ -	$46,953	$ -
CFC/Power Supply	5,000	-	5,000	-
RTFC	3,580	-	-	-
Total	16,164	-	51,953	-
With a specific allowance recorded:				
NCSC	450	55		
RTFC	1,815	459	10,497	3,427
Total	2,265	514	10,497	3,427
Total impaired loans	$18,429	$ 514	$62,450	$ 3,427

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

	Three Months Ended February 28,			
	2014	2013	2014	2013
(Dollars in thousands)	Average Recorded Investment		Interest Income Recognized	
CFC/Distribution	$ 7,584	$ 70,111	$ -	$ 435
CFC/Power Supply	5,000	5,000	-	-
NCSC	454	-	-	-
RTFC	5,527	6,497	-	-
Total impaired loans	$ 18,565	$ 81,608	$ -	$ 435

	Nine Months Ended February 28,			
	Average Recorded Investment		Interest Income Recognized	
(Dollars in thousands)	2014	2013	2014	2013
CFC/Distribution	$11,939	$208,632	$ 136	$ 13,522
CFC/Power Supply	5,000	5,000	-	-
NCSC	151	-	-	-
RTFC	7,735	6,668	-	-
Total impaired loans	$24,825	$220,300	$ 136	$ 13,522

Nonperforming and Restructured Loans

Foregone interest income as a result of holding loans on non-accrual status:

	Three Months Ended February 28,		Nine Months Ended February 28,	
(Dollars in thousands)	2014	2013	2014	2013
Nonperforming loans	$ 120	$ 355	$ 440	$ 1,135
Restructured loans	122	-	367	-
Total	$ 242	$ 355	$ 807	$ 1,135

At February 28, 2014 and May 31, 2013, nonperforming loans totaled $11 million, or 0.05 percent, of loans outstanding and $15 million, or 0.08 percent, of loans outstanding, respectively. One borrower in this group is currently in bankruptcy. The debtor and certain secured creditors have negotiated a settlement for an agreed upon plan of reorganization. Another borrower in this group received a reversal of an unfavorable ruling related to state Universal Service Fund (“USF”) payments. In March 2014, this borrower made a payment moving its loans to current payment status. There is one other borrower in this group that is currently seeking a buyer for its system, as it is not anticipated that it will have sufficient cash flow to repay its loans without the proceeds from the sale of the business. It is currently anticipated that even with the sale of the business, there will not be sufficient funds to repay the full amount owed. We have approval rights with respect to the sale of this company.

At February 28, 2014 and May 31, 2013, we had restructured loans totaling $8 million, or 0.04 percent, of loans outstanding and $47 million, or 0.23 percent, of loans outstanding, respectively, all of which were performing according to their restructured terms. No interest income was accrued on restructured loans during the three months ended February 28, 2014 compared to $0.4 million of interest income during the prior-year period. Approximately $0.1 million of interest income was accrued on restructured loans during the nine months ended February 28, 2014, compared with $14 million of interest income in the prior-year period. One of the restructured loans totaling $39 million at May 31, 2013, was refinanced without concession during the first quarter of fiscal year 2014, with the new loan classified as performing at February 28, 2014. This loan was on accrual status since the time of restructuring. At February 28, 2014, all restructured loans were on non-accrual status.

We believe our allowance for loan loss is appropriate to cover the losses inherent in our loan portfolio at February 28, 2014.

Pledging of Loans and Loans on Deposit

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

The following table summarizes our loans outstanding as collateral pledged to secure our collateral trust bonds, Clean Renewable Energy Bonds and notes payable to the Federal Agricultural Mortgage Corporation and the amount of the corresponding debt outstanding (see Note 5, *Short-Term Debt and Credit Arrangements* and Note 6, *Long-Term Debt*).

(Dollars in thousands)	February 28, 2014	May 31, 2013
Collateral trust bonds:		
2007 indenture		
Distribution system mortgage notes	$5,454,096	$5,674,804
RUS guaranteed loans qualifying as permitted investments	162,509	165,823
Total pledged collateral	$5,616,605	$5,840,627
Collateral trust bonds outstanding	5,179,372	4,679,372
1994 indenture		
Distribution system mortgage notes	$1,567,122	$1,641,858
Collateral trust bonds outstanding	1,310,000	1,465,000
Federal Agricultural Mortgage Corporation:		
Distribution and power supply system mortgage notes	$1,784,959	$1,795,947
Notes payable outstanding	1,523,032	1,542,474

Clean Renewable Energy Bonds Series 2009A:		
Distribution and power supply system mortgage notes	$21,932	$23,536
Cash	7,221	7,634
Total pledged collateral	$29,153	$31,170
Notes payable outstanding	18,230	19,888

We are required to maintain collateral on deposit in an amount at least equal to the balance of debt outstanding to the Federal Financing Bank of the United States Treasury issued under the Guaranteed Underwriter program of the U.S. Department of Agriculture (the "Guaranteed Underwriter Program"). See Note 6, *Long-Term Debt*.

The following table shows the collateral on deposit and the amount of the corresponding debt outstanding:

(Dollars in thousands)	February 28, 2014	May 31, 2013
Federal Financing Bank		
Distribution and power supply system mortgage notes on deposit	$4,387,115	$3,903,786
Notes payable outstanding	3,999,000	3,674,000

(4) Foreclosed Assets

Assets received in satisfaction of loan receivables are initially recorded at fair value when received and subsequently evaluated for impairment. These assets are classified on the condensed consolidated balance sheets as foreclosed assets. At February 28, 2014, all foreclosed assets were held by DRP and CAH, which are wholly-owned subsidiaries of CFC.

The activity for foreclosed assets is summarized below:

	Nine Months Ended February 28, 2014		
(Dollars in thousands)	CAH	DRP	Total
Balance as of May 31, 2013	$248,049	$13,423	$261,472
Results of operations	(7,853)	(629)	(8,482)
Cash investments (proceeds)	7,410	(5,250)	2,160
Balance as of February 28, 2014	$247,606	$7,544	$255,150

During the nine months ended February 28, 2014, our investment in the DRP foreclosed assets decreased primarily due to net cash proceeds received of $5 million from the sale of raw land and developed lots and bonds reimbursements received.

(5) Short-Term Debt and Credit Arrangements

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

(Dollars in thousands)	February 28, 2014	May 31, 2013
Short-term debt:		
Commercial paper sold through dealers, net of discounts (1)	$2,611,744	$2,009,884
Commercial paper sold directly to members, at par (1)	916,675	812,141
Commercial paper sold directly to non-members, at par (1)	20,160	39,298
Select notes	496,031	358,390
Daily liquidity fund notes sold directly to members	590,724	680,419
Bank bid notes	150,000	150,000
Subtotal short-term debt	4,785,334	4,050,132
Long-term debt maturing within one year:		
Medium-term notes sold through dealers	270,282	989,607
Medium-term notes sold to members	365,845	391,318
Secured collateral trust bonds	854,605	1,504,949
Loan and guarantees subordinated certificates	53,370	37,176
Member capital securities	181,480	-
Secured notes payable	27,174	742,402
Unsecured notes payable	3,897	3,899
Total long-term debt maturing within one year	1,756,653	3,669,351
Total short-term debt	$6,541,987	$7,719,483

(1) Backup liquidity is provided by our revolving credit agreements.

Revolving Credit Agreements

At February 28, 2014 and May 31, 2013, we had $3,445 million and $3,100 million, respectively, of commitments under revolving credit agreements. We may request letters of credit for up to $100 million under each agreement in place at February 28, 2014, which then reduces the amount available under the facility. Our bank lines of credit may be used for general corporate purposes; however, we use them primarily as backup liquidity for dealer and member commercial paper.

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

	Total Available		Letters of Credit Outstanding			
(Dollars in thousands)	February 28, 2014	May 31, 2013	February 28, 2014	May 31, 2013	Maturity	Facility Fee Per Year (1)
Three-year agreement	$219,000	$219,000	$ -	$ -	March 21, 2014	15 basis points
Three-year agreement	1,036,000	916,000	-	-	October 28, 2016	10 basis points
Four-year agreement	1,122,500	1,007,500	-	-	October 28, 2017	10 basis points
Five-year agreement	1,065,609	954,012	1,891	3,488	October 28, 2018	10 basis points
Total	3,443,109	$3,096,512	$ 1,891	$ 3,488		

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

On October 28, 2013, we amended our $1,006 million three-year, $1,088 million four-year, and $1,033 million five-year revolving credit agreements to extend the maturity dates for the three-year, four-year, and five-year revolving credit agreements by one year each to October 28, 2016, 2017 and 2018, respectively. On February 7, 2014, we exercised our option to increase the commitment level for the three-year revolving credit agreement maturing on October 28, 2016, four-year revolving credit agreement maturing on October 28, 2017, and five-year revolving credit agreement maturing on October 28, 2018 by a total of $100 million to $1,036 million, $1,122 million, and $1,068 million, respectively.

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

	Requirement	Actual February 28, 2014	May 31, 2013
Minimum average adjusted TIER over the six most recent fiscal quarters (1)	1.025	1.28	1.27
Minimum adjusted TIER for the most recent fiscal year (1) (2)	1.05	1.29	1.29
Maximum ratio of adjusted senior debt to total equity (1)	10.00	5.92	5.85

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

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

At February 28, 2014 and May 31, 2013, we were in compliance with all covenants under our revolving credit agreements and there were no borrowings outstanding under these agreements.

(6) Long-Term Debt

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

(Dollars in thousands)	February 28, 2014	May 31, 2013
Unsecured long-term debt:		
Medium-term notes sold through dealers	$1,783,171	$1,528,424
Medium-term notes sold to members	119,098	182,790
Subtotal	1,902,269	1,711,214
Unamortized discount	(616)	(627)
Total unsecured medium-term notes	1,901,653	1,710,587
Unsecured notes payable	4,032,167	3,709,074
Unamortized discount	(796)	(920)

Total unsecured notes payable	4,031,371	3,708,154
Total unsecured long-term debt	5,933,024	5,418,741
Secured long-term debt:		
Collateral trust bonds	5,634,372	4,639,372
Unamortized discount	(178,564)	(181,640)
Total secured collateral trust bonds	5,455,808	4,457,732
Secured notes payable	1,514,088	819,960
Total secured long-term debt	6,969,896	5,277,692
Total long-term debt	$12,902,920	$10,696,433

In June 2013, we issued $400 million of 2.35 percent collateral trust bonds due 2020. In November 2013, we issued $400 million of 3.40 percent collateral trust bonds due 2023. On December 16, 2013, we redeemed $150 million of our $600 million 4.75 percent collateral trust bonds due March 1, 2014. The premium and unamortized issuance costs totaling $1.5 million were recorded during the third quarter of fiscal 2014. In January 2014, we issued $300 million of 1.10% collateral trust bonds due 2017 and $300 million of 2.15% collateral trust bonds due 2019.

At February 28, 2014 and May 31, 2013, we had unsecured notes payable totaling $3,999 million and $3,674 million, respectively, outstanding under bond purchase agreements with the Federal Financing Bank and a bond guarantee agreement with RUS issued under the Guaranteed Underwriter program, which provides guarantees to the Federal Financing Bank. During the nine months ended February 28, 2014, we borrowed $325 million under our committed loan facilities with the Federal Financing Bank. On November 21, 2013, we closed on a $500 million commitment from RUS to guarantee a loan from the Federal Financing Bank as part of the Guaranteed Underwriter Program that is available for advance through October 15, 2016. Advances under this facility have a 20 year maturity repayment period. At February 28, 2014, we had an aggregate amount of $924 million available under committed term loan facilities from the Federal Financing Bank as part of this program. We are required to maintain collateral on deposit in an amount at least equal to the balance of debt outstanding to the Federal Financing Bank under this program.

At February 28, 2014 and May 31, 2013, secured notes payable include $1,523 million and $1,542 million, respectively, in debt outstanding to the Federal Agricultural Mortgage Corporation under a note purchase agreement totaling $3,900 million. At February 28, 2014 and May 31, 2013, $26 million and $741 million, respectively, in debt outstanding to the Federal Agricultural Mortgage Corporation had a remaining maturity of less than one year and was classified as short-term debt and

$1,497 and $801 million, respectively, was classified as long-term debt. Under the terms of the 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 remaining term.

The agreement with the Federal Agricultural Mortgage Corporation is a revolving credit facility that allows us to borrow, repay and re-borrow funds at any time through maturity or from time to time as market conditions permit, provided that the principal amount at any time outstanding under the note purchase agreement is not more than the total available under the agreement. We are required to pledge eligible distribution system or power supply system loans as collateral in an amount at least equal to the total principal amount of notes outstanding under the agreement. See Note 3, *Loans and Commitments*, for additional information on the collateral pledged to secure notes payable under these programs.

(7) Subordinated Deferrable Debt

At February 28, 2014 and May 31, 2013, we had $400 million of 4.75 percent subordinated deferrable debt outstanding due 2043. Subordinated deferrable debt currently outstanding is callable at par on or after April 30, 2023.

(8) Derivative Financial Instruments

We are an end user of financial derivative instruments and not a swap dealer. We utilize derivatives such as interest rate swaps and treasury rate locks to manage our interest rate risk exposure.

The following table shows the notional amounts outstanding and the weighted-average rate paid and received for our interest rate swaps by type:

(Dollars in thousands)	February 28, 2014			May 31, 2013		
	Notional Amount	Weighted-Average Rate Paid	Weighted-Average Rate Received	Notional amount	Weighted-Average Rate Paid	Weighted-Average Rate Received
Pay fixed-receive variable	$5,172,809	3.36 %	0.22 %	$5,287,889	3.39 %	0.26 %
Pay variable-receive fixed	3,124,000	0.86	3.62	3,500,440	1.12	4.62
Total interest rate swaps	$8,296,809	2.42	1.50	$8,788,329	2.49	2.00

The derivative gains (losses) line item of the condensed consolidated statement of operations includes cash settlements and derivative forward value for derivative instruments that do not meet hedge accounting criteria. Gains and losses recorded on the condensed consolidated statements of operations for our interest rate swaps are summarized below:

	Three Months Ended February 28,		Nine Months Ended February 28,	
(Dollars in thousands)	2014	2013	2014	2013
Derivative cash settlements	$(18,788)	$(14,607)	$(54,944)	$(43,926)
Derivative forward value	(12,835)	61,233	98,925	62,194
Derivative (losses) gains	$(31,623)	$46,626	$43,981	$18,268

Rating Triggers for Derivatives

Some of our interest rate swaps have credit risk-related contingent features referred to as rating triggers. Rating triggers are not separate financial instruments and are not required to be accounted for separately as derivatives. At February 28, 2014, the following notional amounts of derivative instruments had rating triggers based on our senior unsecured credit ratings from Moody's Investors Service or Standard & Poor's Corporation falling to a level specified in the applicable agreements and are grouped into the categories below. In calculating the payments and collections required upon termination, we netted the agreements for each counterparty, as allowed by the underlying master agreements. At February 28, 2014, our senior unsecured credit ratings from Moody's Investors Service and Standard & Poor's Corporation were A2 and A, respectively. At February 28, 2014, both Moody's Investors Service and Standard & Poor's Corporation had our ratings on stable outlook.

(Dollars in thousands)	Notional Amount	Our Required Payment	Amount We Would Collect	Net Total
Mutual rating trigger if ratings:				
fall to Baa1/BBB+ (1)	$-	$ -	$ -	$-
fall below Baa1/BBB+ (1)	6,576,953	(160,733)	75,860	(84,873)
Total	$6,576,953	$ (160,733)	$ 75,860	$(84,873)

(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 in the preceding table, at February 28, 2014, we had a total notional outstanding amount of $450 million of derivative instruments with one counterparty that would require the pledging of collateral totaling $9 million (the fair value of such derivative instruments excluding credit risk) if our senior unsecured ratings from Moody's Investors Service were to fall below Baa2 or if the ratings from Standard & Poor's Corporation were to fall below BBB. The aggregate fair value, net of the credit risk valuation adjustment, of all interest rate swaps with rating triggers that were in a net liability position at February 28, 2014 was $167 million.

Offsetting Derivatives Assets and Liabilities

As noted previously, all of our master swap agreements include netting provisions that allow for offsetting of all contracts with a given counterparty in the event of default by one of the two parties to the transaction. Notwithstanding netting provisions, our derivative assets and liabilities are not offset in the accompanying condensed consolidated balance sheets. The following table provides information on the gross fair value of derivative assets and liabilities and the gross amounts that are not offset in the condensed consolidated balance sheets.

	February 28, 2014					
			Net Amounts of Assets/	Gross Amounts Not Offset in the Balance Sheet		
(Dollars in thousands)	Gross Amounts of Recognized Assets/ Liabilities	Gross Amounts Offset in the Balance Sheet	Liabilities Presented in the Balance Sheet	Financial Instruments	Cash Collateral Pledged	Net Amount
Assets:						
Derivatives - Interest rate swaps	$261,598	$ -	$ 261,598	$ 193,733	$ -	$67,865
Liabilities:						

Derivatives - Interest rate swaps	380,518	-	380,518	193,733	-	186,785

	May 31, 2013					
			Net Amounts of Assets/	Gross Amounts Not Offset in the Balance Sheet		
(Dollars in thousands)	Gross Amounts of Recognized Assets/ Liabilities	Gross Amounts Offset in the Balance Sheet	Liabilities Presented in the Balance Sheet	Financial Instruments	Cash Collateral Pledged	Net Amount
Assets:						
Derivatives - Interest rate swaps	$257,878	$ -	$ 257,878	$ 203,161	$ -	$54,717
Liabilities:						
Derivatives - Interest rate swaps	475,278	-	475,278	203,161	-	272,117

(9) Equity

In May 2013, the CFC Board of Directors authorized the allocation of $1 million of fiscal year 2013 net earnings to the Cooperative Educational Fund. In July 2013, the CFC Board of Directors authorized the allocation of the fiscal year 2013 net earnings as follows: $138 million to the members' capital reserve and $81 million to members in the form of patronage capital. In July 2013, the CFC Board of Directors authorized the retirement of allocated net earnings totaling $41 million, representing 50 percent of the fiscal year 2013 allocation. This amount was returned to members in cash on October 1, 2013. Future allocations and retirements of net earnings may be made annually as determined by the CFC Board of Directors with due regard for its financial condition. The CFC Board of Directors has the authority to change the current practice for allocating and retiring net earnings at any time, subject to applicable laws and regulations.

(10) Guarantees

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

(Dollars in thousands)	February 28, 2014	May 31, 2013
Total by type:		
Long-term tax-exempt bonds	$519,185	$547,970
Letters of credit	472,008	447,683
Other guarantees	115,018	117,118
Total	$1,106,211	$1,112,771
Total by member class:		
CFC:		
Distribution	$209,336	$245,265
Power supply	801,785	810,900
Statewide and associate	5,488	6,948
CFC total	1,016,609	1,063,113
RTFC	2,304	3,711
NCSC	87,298	45,947
Total	$1,106,211	$1,112,771

The maturities for the long-term tax-exempt bonds and the related guarantees run through calendar year 2042. Amounts in the table represent the outstanding principal amount of the guaranteed bonds. At February 28, 2014, our maximum potential exposure for the $73 million of fixed-rate tax-exempt bonds is $120 million, representing principal and interest. Of the amounts shown in the table above for long-term tax-exempt bonds, $446 million and $473 million as of February 28, 2014 and May 31, 2013, respectively, are adjustable or floating-rate bonds that may be converted to a fixed rate as specified in the applicable indenture for each bond offering. We are unable to determine the maximum amount of interest that we could be required to pay related to the remaining adjustable and floating-rate bonds. Many of these bonds have a call provision that in the event of a default allow us to trigger the call provision. This would limit our exposure to future interest payments on these bonds. Our maximum potential exposure is secured by a mortgage lien on all of the member system’s assets and future revenue. If the debt is accelerated because of a determination that the interest thereon is not tax-exempt, the system’s obligation to reimburse us for any guarantee payments will be treated as a long-term loan.

The maturities for letters of credit run through calendar year 2024. The amounts shown in the table above represent our maximum potential exposure, of which $131 million is secured at February 28, 2014. Security provisions include a mortgage lien on substantially all of the system’s assets, future revenue and the system’s investment in our commercial paper.

In addition to the letters of credit listed in the table, under master letter of credit facilities in place at February 28, 2014, we may be required to issue up to an additional $168 million in letters of credit to third parties for the benefit of our members. As of February 28, 2014, all of our master letter of credit facilities were subject to material adverse change clauses at the time of issuance. Also, at February 28, 2014 we had hybrid letter of credit facilities totaling $1,615 million that represent commitments that may be used for the issuance of letters of credit or line of credit loan advances, at the option of a borrower, and are included in unadvanced loan commitments for line of credit loans reported in Note 3, *Loans and Commitments*. Hybrid letter of credit facilities subject to material adverse change clauses at the time of issuance totaled $353 million at February 28, 2014. Prior to issuing a letter of credit, we would confirm that there has been no material adverse change in the business or condition, financial or otherwise, of the borrower since the time the loan was approved and confirm that the borrower is currently in compliance with the letter of credit terms and conditions. The remaining commitment under hybrid letter of credit facilities of $1,262 million may be used for the issuance of letters of credit as long as the borrower is in compliance with the terms and conditions of the facility.

The maturities for other guarantees listed in the table run through calendar year 2025. The maximum potential exposure for these other guarantees is $116 million, all of which is unsecured.

At February 28, 2014 and May 31, 2013, we had $456 million and $410 million of guarantees, respectively, representing 41 percent of total guarantees at the end of each period, under which our right of recovery from our members was not secured.

At February 28, 2014, we were the liquidity provider for a total of $571 million of variable-rate tax-exempt bonds issued for our member cooperatives. As liquidity provider on these $571 million of tax-exempt bonds, we are required to purchase bonds that are tendered or put by investors. Investors provide notice to the remarketing agent that they will tender or put a certain amount of bonds at the next interest rate reset date. If the remarketing agent is unable to sell such bonds to other investors by the next interest rate reset date, we have unconditionally agreed to purchase such bonds. On a total of $446 million of the bonds for which we are liquidity provider, we also provide a guarantee of all principal and interest, which is shown in the chart above as a tax-exempt bond guarantee. On a total of $125 million of tax-exempt bonds, our obligation as liquidity provider is in the form of a letter of credit which is reflected in our letters of credit. During the nine months ended February 28, 2014, we were not required to perform as liquidity provider pursuant to these obligations.

Guarantee Liability

At February 28, 2014 and May 31, 2013, we recorded a guarantee liability of $23 million and $25 million, respectively, which represents the contingent and non-contingent exposures related to guarantees and liquidity obligations associated with our members' debt. The contingent guarantee liability at February 28, 2014 and May 31, 2013 was $2 million based on management's estimate of exposure to losses within the guarantee portfolio. The remaining balance of the total guarantee liability of $21 million and $23 million, respectively, at February 28, 2014 and May 31, 2013 relates to our non-contingent obligation to stand ready to perform over the term of our guarantees and liquidity obligations that we have entered into or modified since January 1, 2003.

Activity in the guarantee liability account is summarized below:

(Dollars in thousands)	Nine Months Ended February 28, 2014
Beginning balance as of May 31, 2013	$ 24,742
Net change in non-contingent liability	(1,729)
Provision for contingent guarantee liability	159
Ending balance as of February 28, 2014	$ 23,172
Liability as a percentage of total guarantees	2.09 %

(11) Fair Value Measurement

Fair Value

Assets and liabilities measured at fair value on either a recurring or non-recurring basis on the condensed consolidated balance sheets at February 28, 2014 and May 31, 2013 consisted of investments in common stock and preferred stock, derivative instruments, and collateral-dependent nonperforming loans.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

We account for derivative instruments in the condensed consolidated balance sheets as either an asset or liability measured at fair value. There is not an active secondary market for the types of interest rate swaps we use. Our process to estimate the fair value of our derivative instruments involves multiple steps including consideration of indicative quotes from counterparties and use of a discounted cash flow model. We obtain indicative quotes from the interest rate swap counterparties to estimate fair value on a quarterly basis. The indicative quotes are based on the expected future cash flow and the estimated yield curve.

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

Our valuation technique for interest rate swaps is based on discounted cash flows and we utilize observable inputs, which reflect market data. To calculate fair value, we determine the forward curve. The forward curve allows us to determine the projected floating rate cash flows and the discount factors needed to calculate the net present value of each interest payment. The significant observable inputs for our derivatives include Spot LIBOR rates, Eurodollar futures contracts, and market swap rates.

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

Our investments in equity securities include investments in the Federal Agricultural Mortgage Corporation Class A common stock and Series A preferred stock, and are recorded in the condensed consolidated balance sheet at fair value. We calculate fair value of the investments based on the quoted price on the stock exchange where the stock is traded. That stock exchange is an active market based on the volume of shares transacted. Fair values for these securities are classified as a Level 1 valuation. For the three and nine months ended February 28, 2014 we recorded an unrealized gain of $2 million and an unrealized loss of $3 million, respectively, compared with an unrealized loss of $0.5 million and unrealized gain of $0.4 million, respectively, for the prior-year periods in accumulated other comprehensive income on the condensed consolidated balance sheet.

Deferred compensation investments are recorded in the condensed consolidated balance sheets in the other assets category at fair value. We calculate fair value based on the quoted price on the stock exchange where the funds are traded. That stock exchange is an active market based on the volume of shares transacted. The amounts are invested in highly liquid indices and mutual funds and are classified within Level 1 of the fair value hierarchy.

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

	February 28, 2014		May 31, 2013	
(Dollars in thousands)	Level 1	Level 2	Level 1	Level 2
Derivative assets	$-	$261,598	$-	$257,878
Derivative liabilities	-	380,518	-	475,278
Investments in common and preferred stock	28,702	-	31,632	-
Deferred compensation investments	4,035	-	3,716	-

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

We may be required, from time to time, to measure certain assets at fair value on a non-recurring basis in accordance with GAAP. Any adjustments to fair value usually result from application of lower-of-cost or fair value accounting or write-downs of individual assets. At February 28, 2014 and May 31, 2013, we measured certain collateral-dependent nonperforming loans at fair value. We utilize the collateral fair value underlying the loan in estimating the specific loan loss allowance. To estimate the fair value of the collateral, we may use third party valuation specialists, internal estimates or a combination of both. The valuation technique used to determine fair value of the nonperforming loans provided by both our internal staff and third party specialists includes market multiples (i.e., comparable companies). The significant unobservable inputs used in the determination of fair value include EBITDA multiples ranging from 3.5x to 5.0x. The material inputs used in estimating fair value by both internal staff and third party specialists are Level 3 within the fair value hierarchy. In these instances, the valuation is considered to be a non-recurring item. The significant unobservable inputs for Level 3 assets that are valued using fair values obtained from third party specialists are reviewed by our Credit Risk Management group to assess the reasonableness of the assumptions used and the accuracy of the work performed. In cases where we rely on third party inputs, we use the final unadjusted third party valuation analysis as support for any financial statement adjustments and disclosures to the financial statements. The valuation techniques and significant unobservable inputs for assets classified as Level 3 in the fair value hierarchy, which are measured using an internal model, are independently reviewed by other internal staff.

Assets measured at fair value on a non-recurring basis at February 28, 2014 and May 31, 2013, were classified as Level 3 within the fair value hierarchy. Any increase or decrease to significant unobservable inputs used in the determination of fair value will not have a material impact on the fair value measurement of those assets or to the results of operations of the Company. For the three and nine months ended February 28, 2014 and 2013, respectively, there were no losses on our nonperforming loans. The following table provides the carrying/fair value of the related individual assets at February 28, 2014 and May 31, 2013:

	Level 3 Fair Value	
	February 28,	May 31,
(Dollars in thousands)	2014	2013
Nonperforming loans, net of specific reserves	$10,331	$12,070

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(12) Fair Value of Financial Instruments

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

	February 28, 2014		May 31, 2013	
(Dollars in thousands)	Carrying value	Fair Value	Carrying Value	Fair Value
Assets:				
Cash and cash equivalents	$842,915	$842,915	$177,062	$177,062
Restricted cash	7,256	7,256	7,696	7,696
Investments	28,702	28,702	31,632	31,632
Time deposits	700,000	700,000	700,000	700,000
Deferred compensation investments	4,035	4,035	3,716	3,716
Loans to members, net	20,589,024	21,015,784	20,251,549	21,318,406
Debt service reserve funds	39,353	39,353	39,803	39,803
Derivative instruments	261,598	261,598	257,878	257,878
Liabilities:				
Short-term debt	6,541,987	6,547,673	7,719,483	7,751,021
Long-term debt	12,902,920	14,079,914	10,696,433	12,156,097
Guarantee liability	23,172	26,061	24,742	27,730
Derivative instruments	380,518	380,518	475,278	475,278
Subordinated deferrable debt	400,000	372,200	400,000	404,300
Members' subordinated certificates	1,486,965	1,486,965	1,729,226	1,880,672
Off-balance sheet instruments:				
Commitments	-	-	-	-

See Note 11, *Fair Value Measurement,* for more details on assets and liabilities measured at fair value on a recurring or non-recurring basis on our condensed consolidated balance sheets. We consider observable prices in the principal market in our valuations where possible. Fair value estimates were developed at the reporting date and may not necessarily be indicative of amounts that could ultimately be realized in a market transaction at a future date. There were no transfers between levels of the fair value hierarchy during the nine months ended February 28, 2014 and the year ended May 31, 2013.

With the exception of redeeming debt under early redemption provisions, terminating derivative instruments under early termination provisions and allowing borrowers to prepay their loans, we held and intend to hold all financial instruments to maturity excluding common stock and preferred stock investments that have no stated maturity. Below is a summary of significant methodologies used in estimating fair value amounts at February 28, 2014 and May 31, 2013.

Cash and Cash Equivalents

Cash and cash equivalents includes cash and certificates of deposit with original maturities of less than 90 days. Cash and cash equivalents are valued at the carrying value, which approximates fair value. Cash and cash equivalents are classified within Level 1 of the fair value hierarchy. At February 28, 2014 and May 31, 2013, cash and cash equivalents classified within Level 1 of the fair value hierarchy totaled $843 million and $177 million, respectively.

Restricted Cash

Restricted cash consists of cash and cash equivalents for which use is contractually restricted. Restricted cash is valued at the carrying value, which approximates fair value. Restricted cash is classified within Level 1 of the fair value hierarchy. At February 28, 2014 and May 31, 2013, restricted cash classified within Level 1 of the fair value hierarchy totaled $7 million and $8 million, respectively.

Investments

Our investments include investments in the Federal Agricultural Mortgage Corporation Class A common stock and Series A preferred stock. The Class A common stock and Series A preferred stock are classified as available-for-sale securities and recorded in the condensed consolidated balance sheets at fair value. We calculate fair value based on the quoted price on the stock exchange where the stock is traded. That stock exchange is an active market based on the volume of shares transacted. The common stock and preferred stock are classified within Level 1 of the fair value hierarchy. At February 28, 2014 and May 31, 2013, investments classified within Level 1 of the fair value hierarchy totaled $29 million and $32 million, respectively.

Time Deposits

Time deposits with financial institutions in interest bearing accounts have maturities of less than one year as of the reporting date and are valued at the carrying value, which approximates fair value. The deposits are classified within Level 2 of the fair value hierarchy. At February 28, 2014 and May 31, 2013, time deposits classified within Level 2 of the fair value hierarchy totaled $700 million.

Deferred Compensation Investments

CFC offers a non-qualified 457(b) deferred compensation plan to highly compensated employees. Such amounts deferred by employees are invested by the company. The deferred compensation investments are recorded in the condensed consolidated balance sheets in the other assets category at fair value. We calculate fair value based on the quoted price on the stock exchange where the funds are traded. That stock exchange is an active market based on the volume of shares transacted. The amounts are invested in highly liquid indices and mutual funds and are classified within Level 1 of the fair value hierarchy. At February 28, 2014 and May 31, 2013, deferred compensation investments classified within Level 1 of the fair value hierarchy totaled $4 million.

Loans to Members, net

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

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

Loans with different risk characteristics, specifically nonperforming and restructured loans, are valued by using collateral valuations or by adjusting cash flows for credit risk and discounting those cash flows using the current rates at which similar loans would be made by us to borrowers for the same remaining maturities. See Note 11, *Fair Value Measurement*, for more details about how we calculate the fair value of certain nonperforming loans.

The carrying value of our variable rate loans adjusted for credit risk approximates fair value since variable-rate loans are eligible to be reset at least monthly.

Loans to members are classified within Level 3 of the fair value hierarchy and at February 28, 2014 and May 31, 2013, totaled $21,016 million and $21,318 million, respectively.

Debt Service Reserve Funds

Debt service reserve funds represent cash and/or investments on deposit with the bond trustee for tax-exempt bonds that we guarantee. Debt service reserve fund investments are comprised of actively traded tax exempt municipal bonds and commercial paper. Carrying value is considered to be equal to fair value. Debt service reserve funds are classified within Level 1 of the fair value hierarchy. At February 28, 2014 and May 31, 2013, debt service reserve funds classified within Level 1 of the fair value hierarchy totaled $39 million and $40 million, respectively.

Short-Term Debt

Short-term debt consists of commercial paper, select notes, bank bid notes, daily liquidity fund and other long-term debt due within one year. The fair value of short-term debt with maturities less than or equal to 90 days is carrying value, which is a reasonable estimate of fair value. The fair value of short-term debt with maturities greater than 90 days is estimated based on discounted cash flows and quoted market rates for debt with similar maturities. Short-term debt classified within Level 1 of the fair value hierarchy is comprised of dealer commercial paper, bank bid notes, and daily liquidity fund. At February 28, 2014 and May 31, 2013, short-term debt classified within Level 1 of the fair value hierarchy is based on quoted prices in active markets and totaled $3,353 million and $2,840 million, respectively.

Short-term debt classified within Level 2 of the fair value hierarchy is comprised of member commercial paper, non-member commercial paper and select notes. At February 28, 2014 and May 31, 2013, short-term debt classified within Level 2 of the fair value hierarchy was determined based on discounted cash flows using discount rates consistent with current market rates for similar products with similar remaining terms and totaled $1,433 million and $1,210 million, respectively. Short-term debt classified within Level 2 also includes our collateral trust bonds and medium-term notes maturing within one year. At February 28, 2014 and May 31, 2013, such short-term debt classified within Level 2 of the fair value hierarchy totaled $1,495 million and $2,912 million, respectively. The fair value of short term debt classified within Level 2 of the fair value hierarchy was determined based on discounted cash flows using a pricing model that incorporates available market information such as indicative benchmark yields and credit spread assumptions that are provided by third party pricing services such as our banks that underwrite our other debt transactions.

Short-term debt classified within Level 3 of the fair value hierarchy includes our notes payable, members' subordinated certificates and members' capital securities due within one year and totaled $267 million and $789 million at February 28, 2014 and May 31, 2013, respectively. The fair value of short-term debt classified within Level 3 of the fair value hierarchy was determined based on discounted cash flows using benchmark yields and spreads for similar instruments supplied by underwriter quotes for similar instruments, if available. Secondary trading quotes for our debt instruments used in the determination of fair value incorporate our credit risk.

Long-Term Debt

Long-term debt consists of collateral trust bonds, medium-term notes and long-term notes payable. We issue substantially all collateral trust bonds and some medium-term notes in underwritten public transactions. Collateral trust bonds and medium-term notes are classified within Level 2 of the fair value hierarchy. At February 28, 2014 and May 31, 2013, long-term debt classified within Level 2 of the fair value hierarchy totaled $8,424 million and $7,410 million, respectively. The fair value of long-term debt classified within Level 2 of the fair value hierarchy was determined based on discounted cash flows. There is no active secondary trading for the underwritten collateral trust bonds and medium-term notes; therefore, dealer quotes and recent market prices are both used in estimating fair value. There is essentially no secondary market for the medium-term notes issued to our members or in transactions that are not underwritten; therefore, fair value is estimated based on observable benchmark yields and spreads for similar instruments supplied by banks that underwrite our other debt transactions.

The long-term notes payable are issued in private placement transactions and there is no secondary trading of such debt. Long-term notes payable are classified within Level 3 of the fair value hierarchy. Long-term debt classified within Level 3 of the fair value hierarchy totaled $5,656 million and $4,746 million at February 28, 2014 and May 31, 2013, respectively. The fair value was determined based on discounted cash flows using benchmark yields and spreads for similar instruments supplied by underwriter quotes for similar instruments, if available. Secondary trading quotes for our debt instruments used in the determination of fair value incorporate our credit risk.

Guarantees

The fair value of our guarantee liability is based on the fair value of our contingent and non-contingent exposure related to our guarantees. The fair value of our contingent exposure for guarantees is based on management's estimate of our exposure to losses within the guarantee portfolio using a discounted cash flow method. The fair value of our non-contingent exposure for guarantees issued is estimated based on the total unamortized balance of guarantee fees paid and guarantee fees to be paid discounted at our current short-term funding rate, which represents management's estimate of the fair value of our obligation to stand ready to perform. Guarantees are classified within Level 3 of the fair value hierarchy. At February 28, 2014 and May 31, 2013, guarantees classified within Level 3 of the fair value hierarchy totaled $26 million and $28 million, respectively.

Subordinated Deferrable Debt

Subordinated deferrable debt outstanding was issued in an underwritten public transaction. There is no active secondary trading for this subordinated deferrable debt; therefore, dealer quotes and recent market prices are both used in estimating fair value based on a discounted cash flow method. Subordinated deferrable debt is classified within Level 2 of the fair value hierarchy. At February 28, 2014 and May 31, 2013, subordinated deferrable debt classified within Level 2 of the fair value hierarchy totaled $372 million and $404 million, respectively.

Members' Subordinated Certificates

Members' subordinated certificates include (i) membership subordinated certificates issued to our members, (ii) loan and guarantee subordinated certificates issued as a condition of obtaining loan funds or guarantees and (iii) member capital securities issued as voluntary investments by our members. All members' subordinated certificates are non-transferable other than among members with CFC's consent and there is no ready market from which to obtain fair value quotes. These certificates are valued at par. Members' subordinated certificates are classified within Level 3 of the fair value hierarchy. At February 28, 2014 and May 31, 2013, members' subordinated certificates classified within Level 3 of the fair value hierarchy totaled $1,487 million and $1,881 million, respectively.

Derivative Instruments

We record derivative instruments in the condensed consolidated balance sheets as either an asset or liability measured at fair value. Because there is not an active secondary market for the types of interest rate swaps we use, we obtain indicative quotes from the interest rate swap counterparties to estimate fair value on a quarterly basis. The indicative quotes are based on the expected future cash flow and estimated yield curves. We adjust the market values received from the counterparties using credit default swap levels for us and the counterparties. The credit default swap levels represent the credit risk premium required by a market participant based on the available information related to us and the counterparty. Derivative instruments are classified within Level 2 of the fair value hierarchy. At February 28, 2014 and May 31, 2013, derivative asset instruments classified within Level 2 of the fair value hierarchy totaled $262 million and $258 million, respectively, and derivative liability instruments classified within Level 2 of the fair value hierarchy totaled $381 million and $475 million, respectively.

Commitments

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

(13) Segment Information

The following tables contain the segment presentation for the condensed consolidated statements of operations for the three and nine months ended February 28, 2014 and 2013 and condensed consolidated balance sheets at February 28, 2014 and 2013.

	Three Months Ended February 28, 2014			
(Dollars in thousands)	CFC	Other	Elimination	Consolidated
Statement of operations:				
Interest income	$234,927	$12,613	$ (8,808)	$ 238,732
Interest expense	(163,157)	(9,185)	8,808	(163,534)
Net interest income	71,770	3,428	-	75,198
Provision for loan losses	(787)	-	-	(787)
Net interest income after provision for loan losses	70,983	3,428	-	74,411
Non-interest income:				
Fee and other income	5,127	374	201	5,702
Derivative losses	(30,808)	(815)	-	(31,623)
Results of operations from foreclosed assets	(1,164)	-	-	(1,164)
Total non-interest income	(26,845)	(441)	201	(27,085)
Non-interest expense:				
General and administrative expenses	(14,477)	(2,505)	(201)	(17,183)
Provision for guarantee liability	(117)	-	-	(117)
Losses on early extinguishment of debt	(1,452)	-	-	(1,452)
Other	210	-	-	210
Total non-interest expense	(15,836)	(2,505)	(201)	(18,542)
Income prior to income taxes	28,302	482	-	28,784
Income tax expense	-	(243)	-	(243)

Net income	$28,302	$239	$ -	$ 28,541

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	Three Months Ended February 28, 2013			
(Dollars in thousands)	CFC	Other	Elimination	Consolidated
Statement of operations:				
Interest income	$ 230,039	$ 13,971	$ (9,989)	$ 234,021
Interest expense	(171,491)	(10,395)	9,987	(171,899)
Net interest income	58,548	3,576	(2)	62,122

Recovery of loan losses