

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORP /DC/
Form 10-Q
April 08, 2009

FORM 10-Q

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

- ☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended February 28, 2009

OR

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

Commission File Number 1-7102

NATIONAL RURAL UTILITIES COOPERATIVE
FINANCE CORPORATION

(Exact name of registrant as specified in its charter)

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

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

2201 COOPERATIVE WAY, HERNDON, VA 20171
(Address of principal executive offices)

Registrant's telephone number, including area code, is 703-709-6700.

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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 ☒ Smaller reporting company ☐

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

The Registrant is a cooperative and consequently, does not issue any equity capital stock.

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(in thousands)

A S S E T S

| | February 28, 2009 | May 31, 2008 |
|--|----------------------|-----------------|
| Cash and cash equivalents | \$ 453,147 | \$ 177,809 |
| Restricted cash | 7,693 | 14,460 |
| Investments in trading securities | 11,434 | - |
| Investments in preferred stock | 35,000 | - |
| Loans to members | 20,172,499 | 19,029,040 |
| Less: Allowance for loan losses | (638,583) | (514,906) |
| Loans to members, net | 19,533,916 | 18,514,134 |
| Accrued interest and other receivables | 268,012 | 258,315 |
| Fixed assets, net | 36,592 | 21,045 |
| Debt service reserve funds | 47,639 | 54,993 |
| Bond issuance costs, net | 50,357 | 39,618 |
| Foreclosed assets, net | 54,414 | 58,961 |
| Derivative assets | 416,560 | 220,514 |
| Other assets | 32,153 | 19,532 |
| | \$20,946,917 | \$19,379,381 |

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(in thousands)

LIABILITIES AND EQUITY

| | February 28, 2009 | May 31, 2008 |
|---|-------------------------|-----------------|
| Short-term debt | \$ 5,367,410 | \$ 6,327,453 |
| Accrued interest payable | 349,013 | 244,299 |
| Long-term debt | 12,224,456 | 10,173,587 |
| Deferred income | 19,100 | 21,971 |
| Guarantee liability | 33,814 | 15,034 |
| Other liabilities | 50,698 | 27,216 |
| Derivative liabilities | 571,481 | 171,390 |
| Subordinated deferrable debt | 311,440 | 311,440 |
| Members' subordinated certificates: | | |
| Membership subordinated certificates | 649,465 | 649,465 |
| Loan and guarantee subordinated certificates | 823,086 | 757,314 |
| Member capital securities | 96,615 | - |
| Total members' subordinated certificates | 1,569,166 | 1,406,779 |
| Commitments and contingencies | | |
| Minority interest | 11,057 | 14,247 |
| Equity: | | |
| Retained equity | 431,013 | 657,138 |
| Accumulated other comprehensive income | 8,269 | 8,827 |
| Total equity | 439,282 | 665,965 |
| | \$20,946,917 | \$19,379,381 |

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)
(in thousands)

For the Three and Nine Months Ended February 28, 2009 and February 29, 2008

| | Three months ended | | Nine months ended | |
|--|-------------------------|-------------------------|-------------------------|-------------------------|
| | February 28, 2009 | February 29, 2008 | February 28, 2009 | February 29, 2008 |
| Interest income | \$ 271,433 | \$ 266,576 | \$ 806,993 | \$ 797,817 |
| Interest expense | (240,116) | (233,468) | (694,649) | (720,810) |
| Net interest income | 31,317 | 33,108 | 112,344 | 77,007 |
| Recovery of (provision for) loan losses | 10,415 | 33,599 | (126,577) | 47,900 |
| Net interest income (loss) after recovery of (provision for) loan losses | 41,732 | 66,707 | (14,233) | 124,907 |
| Non-interest income: | | | | |
| Rental and other income | 220 | 367 | 842 | 1,070 |
| Derivative cash settlements | 104,012 | 10,463 | 116,946 | 30,299 |
| Results of operations of foreclosed assets | 801 | 2,401 | 3,258 | 6,217 |
| Total non-interest income | 105,033 | 13,231 | 121,046 | 37,586 |
| Non-interest expense: | | | | |
| Salaries and employee benefits | (10,036) | (9,398) | (29,799) | (27,049) |
| Other general and administrative expenses | (6,430) | (5,862) | (16,354) | (16,278) |
| (Provision for) recovery of guarantee liability | (338) | 1,000 | (5,319) | 4,300 |
| Market adjustment on foreclosed assets | (1,652) | (5,840) | (1,805) | (5,840) |
| Derivative forward value | (53,046) | (64,266) | (203,457) | (173,278) |
| Fair value adjustment on investments in trading securities | - | - | (101) | - |
| Loss on sale of loans | - | (158) | - | (676) |

| | | | | |
|---|-----------|----------|--------------|-------------|
| Total non-interest expense | (71,502) | (84,524) | (256,835) | (218,821) |
| Income (loss) prior to income taxes and minority interest | 75,263 | (4,586) | (150,022) | (56,328) |
| Income taxes | (183) | 2,175 | 6,977 | 6,186 |
| Income (loss) prior to minority interest | 75,080 | (2,411) | (143,045) | (50,142) |
| Minority interest | 159 | 2,088 | 3,138 | 8,211 |
| Net income (loss) | \$ 75,239 | \$ (323) | \$ (139,907) | \$ (41,931) |

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(UNAUDITED)

(in thousands)

For the Nine Months Ended February 28, 2009 and February 29, 2008

| | Total | Accumulated Other Comprehensive Income (Loss) | Subtotal Retained Equity | Membership Fees | Unallocated Net Income (Loss) | Education Fund | Members' Capital Reserve | Patronage Capital Allocated General Reserve Fund Other |
|--|------------|---|--------------------------------|--------------------|--|-------------------|--------------------------------|---|
| Nine months ended February 28, 2009: | | | | | | | | |
| Balance as of May 31, 2008 | \$ 665,965 | \$ 8,827 | \$ 657,138 | \$ 993 | \$ 44,003 | \$ 1,484 | \$ 187,409 | \$ 462,753 |
| Patronage capital retirement | (85,526) | - | (85,526) | - | - | - | (217) | (85,309) |
| Loss prior to income taxes and minority interest | (150,022) | - | (150,022) | - | (150,022) | - | - | - |
| Other comprehensive loss | (558) | (558) | - | - | - | - | - | - |
| Income tax benefit | 6,977 | - | 6,977 | - | 6,977 | - | - | - |
| Minority interest | 3,138 | - | 3,138 | - | 3,138 | - | - | - |
| Other | (692) | - | (692) | (1) | - | (691) | (93) | 93 |
| Balance as of February 28, 2009 | \$ 439,282 | \$ 8,269 | \$ 431,013 | \$ 992 | \$ (95,904) | \$ 793 | \$ 187,099 | \$ 437,537 |
| Nine months ended February 29, 2008: | | | | | | | | |
| Balance as of May 31, 2007 | \$ 710,041 | \$ 12,204 | \$ 697,837 | \$ 997 | \$ 131,528 | \$ 1,406 | \$ 158,308 | \$ 490,100 |
| Patronage capital retirement | (85,494) | - | (85,494) | - | - | - | - | (85,494) |
| Loss prior to income taxes and minority interest | (56,328) | - | (56,328) | - | (56,328) | - | - | - |
| Other comprehensive loss | (587) | (587) | - | - | - | - | - | - |

| | | | | | | | | | |
|---------------------------------|------------|-----------|------------|--------|-----------|--------|------------|------------|-----------|
| Income tax benefit | 6,186 | - | 6,186 | - | 6,186 | - | - | - | - |
| Minority interest | 8,211 | - | 8,211 | - | 8,211 | - | - | - | - |
| Other | (700) | - | (700) | (3) | - | (697) | 40 | - | (40) |
| Balance as of February 29, 2008 | \$ 581,329 | \$ 11,617 | \$ 569,712 | \$ 994 | \$ 89,597 | \$ 709 | \$ 158,348 | \$ 498,195 | \$ 19,566 |

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

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

For the Nine Months Ended February 28, 2009 and February 29, 2008

| | February 28, 2009 | February 29, 2008 |
|--|-------------------------|-------------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss | \$ (139,907) | \$ (41,931) |
| Add (deduct): | | |
| Amortization of deferred income | (4,757) | (5,769) |
| Amortization of bond issuance costs and deferred charges | 8,060 | 14,048 |
| Depreciation | 1,710 | 1,698 |
| Provision for (recovery of) loan losses | 126,577 | (47,900) |
| Provision for (recovery of) guarantee liability | 5,319 | (4,300) |
| Results of operations of foreclosed assets | (3,258) | (6,217) |
| Market adjustment on foreclosed assets | 1,805 | 5,840 |
| Derivative forward value | 203,457 | 173,278 |
| Fair value adjustment on investments in trading securities | 101 | - |
| Loss on sale of loans | - | 676 |
| Restricted interest earned on restricted cash | (138) | (17) |
| Purchases of investments in trading securities | (71,405) | - |
| Sales of investments in trading securities | 59,870 | - |
| Changes in operating assets and liabilities: | | |
| Accrued interest and other receivables | (15,039) | (12,684) |
| Accrued interest payable | 104,714 | 33,375 |
| Other | 20,819 | 2,486 |
| Net cash provided by operating activities | 297,928 | 112,583 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Advances made on loans | (7,508,239) | (6,018,988) |
| Principal collected on loans | 6,360,213 | 5,388,629 |
| Net investment in fixed assets | (16,339) | (16,426) |
| Net cash provided by foreclosed assets | 6,000 | 9,055 |
| Net proceeds from sale of loans | - | 73,972 |
| Investment in preferred stock | (35,000) | - |
| Change in restricted cash | 6,768 | (15,706) |

| | | |
|---|-------------------|-------------------|
| Net cash used in investing activities | (1,186,597) | (579,464) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| (Repayments) proceeds from issuances of short-term debt, net | (136,883) | 347,544 |
| Proceeds from issuance of long-term debt, net | 4,341,725 | 1,566,151 |
| Payments for retirement of long-term debt | (3,130,886) | (1,293,720) |
| Payments for retirement of subordinated deferrable debt | - | (175,000) |
| Proceeds from issuance of members' subordinated certificates | 187,603 | 58,714 |
| Payments for retirement of members' subordinated certificates | (17,402) | (16,025) |
| Payments for retirement of patronage capital | (78,479) | (77,378) |
| Payments for retirement of RTFC patronage capital | (1,671) | (9,771) |
| Net cash provided by financing activities | 1,164,007 | 400,515 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | | |
| | 275,338 | (66,366) |
| BEGINNING CASH AND CASH EQUIVALENTS | | |
| | 177,809 | 304,107 |
| ENDING CASH AND CASH EQUIVALENTS | \$ 453,147 | \$ 237,741 |

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

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

For the Nine Months Ended February 28, 2009 and February 29, 2008

| | |
|----------|----------|
| February | February |
| 28, | 29, |
| 2009 | 2008 |

SUPPLEMENTAL DISCLOSURE OF CASH
FLOW INFORMATION:

| | | |
|--|------------|------------|
| Cash paid for interest | \$ 581,876 | \$ 673,387 |
| Cash paid for income taxes | 31 | 1,088 |
| Non-cash financing and investing activities: | | |
| Net decrease in debt service reserve funds/debt service reserve certificates | \$ (7,354) | \$ - |
| Subordinated certificates applied against loan balances | 1,447 | - |
| Patronage capital applied against loan balances | 81 | - |
| Minority interest patronage capital applied against loan balances | 29 | - |

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

(1) General Information and Accounting Policies

(a) General Information

National Rural Utilities Cooperative Finance Corporation ("National Rural" or "the Company") is a private, not-for-profit cooperative association incorporated under the laws of the District of Columbia in April 1969. The principal purpose of National Rural is to provide its members with a source of financing to supplement the loan programs of the Rural Utilities Service ("RUS") of the United States Department of Agriculture. National Rural makes loans to its rural utility system members ("utility members") to enable them to acquire, construct and operate electric distribution, generation, transmission and related facilities. National Rural also provides its members with credit enhancements in the form of letters of credit and guarantees of debt obligations. National Rural is exempt from payment of federal income taxes under the provisions of Section 501(c)(4) of the Internal Revenue Code. National Rural is a not-for-profit member-owned finance cooperative, thus its objective is not to maximize its net income, but to offer its members low-cost financial products and services consistent with sound financial management.

Rural Telephone Finance Cooperative ("RTFC") was incorporated as a private not-for-profit cooperative association in the state of South Dakota in September 1987. In February 2005, RTFC reincorporated as a not-for-profit cooperative association in the District of Columbia. The principal purpose of RTFC is to provide and arrange financing for its rural telecommunications members and their affiliates. RTFC's results of operations and financial condition are consolidated with those of National Rural in the accompanying financial statements. RTFC is headquartered with National Rural in Herndon, Virginia. RTFC is a taxable cooperative that pays income tax based on its net income, excluding net income allocated to its members, as allowed by law under Subchapter T of the Internal Revenue Code.

National Cooperative Services Corporation ("NCSC") was incorporated in 1981 in the District of Columbia as a private non-profit cooperative association. The principal purpose of NCSC is to provide financing to the for-profit or non-profit entities that are owned, operated or controlled by or provide substantial benefit to, members of National Rural. NCSC also markets, through its cooperative members, a consumer loan program for home improvements and an affinity credit card program. NCSC's membership consists of National Rural and distribution systems that are members of National Rural or are eligible for such membership. NCSC's results of operations and financial condition are consolidated with those of National Rural in the accompanying financial statements. NCSC is headquartered with National Rural in Herndon, Virginia. NCSC is a taxable corporation.

The Company's consolidated membership was 1,523 as of February 28, 2009 including 897 utility members, the majority of which are consumer-owned electric cooperatives, 499 telecommunications members, 66 service members and 61 associates in 49 states, the District of Columbia and two U.S. territories. The utility members included 829 distribution systems and 68 generation and transmission ("power supply") systems. Memberships among National Rural, RTFC and NCSC have been eliminated in consolidation. All references to members within this document include members and associates.

In the opinion of management, the accompanying consolidated financial statements contain all adjustments, which consist only of normal recurring accruals, necessary for a fair statement of the Company's results for the interim

periods presented. These interim unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2008.

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, revenues and expenses reported in the financial statements, as well as amounts included in the notes, including discussion and disclosure of contingent liabilities. While the Company uses its 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.

The Company does not believe it is vulnerable to the risk of a near-term severe effect as a result of any concentrations of its activities.

(b) Principles of Consolidation

The accompanying financial statements include the consolidated accounts of National Rural, RTFC and NCSC and certain entities controlled by National Rural and created to hold foreclosed assets and for loan securitization transactions, after elimination of intercompany accounts and transactions. Financial Accounting Standards Board ("FASB") Interpretation No. ("FIN") 46(R), Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin ("ARB") No. 51, ("FIN 46(R)") requires National Rural to consolidate the financial results of RTFC and NCSC. National Rural is the primary beneficiary of variable interests in RTFC and NCSC due to its exposure to absorbing the majority of expected losses.

National Rural is the sole lender to and manages the lending and financial affairs of RTFC through a management agreement in effect until December 1, 2016. Under a guarantee agreement, RTFC pays National Rural a fee in exchange for a reimbursement to RTFC for its loan losses. All loans that require RTFC board approval also require approval by National Rural for funding under RTFC's credit facilities with National Rural. National Rural is not a member of RTFC and does not elect directors to the RTFC board. RTFC has a non-voting associate relationship with National Rural.

National Rural is the primary source of funding to and manages the lending and financial affairs of NCSC through a management agreement which is automatically renewed on an annual basis unless terminated by either party. NCSC funds its programs either through loans from National Rural or commercial paper and long-term notes issued by NCSC and guaranteed by National Rural. In return for these guarantees, NCSC must pay a guarantee fee and purchase from National Rural interest-bearing subordinated term certificates in proportion to the related guarantee. Under a guarantee agreement, NCSC pays National Rural a fee in exchange for reimbursement to NCSC for its loan losses, excluding losses in the consumer loan program. All loans that require NCSC board approval also require approval by National Rural for funding under NCSC's credit facilities with National Rural. National Rural controls the nomination process for 1 out of 11 NCSC directors. The full membership of NCSC elects directors on the basis of one vote for each member. NCSC is a service organization member of National Rural.

RTFC and NCSC creditors have no recourse against National Rural in the event of a default by RTFC and NCSC, unless there is a guarantee agreement under which National Rural has guaranteed NCSC or RTFC debt obligations to a third party. At February 28, 2009, National Rural had guaranteed \$57 million of NCSC debt and derivative instruments with third parties. The maturities for NCSC debt guaranteed by National Rural run through 2022. At February 28, 2009, National Rural's maximum potential exposure totaled \$75 million related to guarantees of NCSC debt and derivatives. Guarantees related to NCSC debt and derivative instruments are not included in Note 12, Guarantees at February 28, 2009 as the debt and derivatives are reported on the consolidated balance sheet. All National Rural loans to RTFC and NCSC are secured by all assets and revenues of RTFC and NCSC. At February 28, 2009, RTFC had total assets of \$1,856 million including loans outstanding to members of \$1,674 million and NCSC had total assets of \$464 million including loans outstanding of \$441 million. RTFC and NCSC loans outstanding to members are included in the loans to members line item in the consolidated balance sheets.

National Rural takes all of the risk related to the funding of the loans to RTFC and NCSC, and in return, National Rural earns a spread over its funding costs on the loans to RTFC and NCSC. At February 28, 2009, National Rural had committed to lend RTFC up to \$4.0 billion of which \$1.7 billion was outstanding. At February 28, 2009, National Rural had committed to provide up to \$1,000 million of credit to NCSC of which \$466 million was outstanding, representing \$409 million of outstanding loans and \$57 million of credit enhancements. RTFC and NCSC loans payable to National Rural are eliminated in consolidation. Total liabilities for RTFC and NCSC were \$1,675 million and \$472 million, respectively, at February 28, 2009.

National Rural established limited liability corporations and partnerships to hold foreclosed assets and form loan securitization transactions. National Rural has full ownership and control of all such entities and thus consolidates their financial results. National Rural presents the companies formed to hold foreclosed assets in one line on the consolidated balance sheets and the consolidated statements of operations. A full consolidation is presented for the company formed for loan securitization transactions.

Unless stated otherwise, references to the Company relate to the consolidation of National Rural, RTFC, NCSC and certain entities controlled by National Rural and created to hold foreclosed assets and for loan securitization transactions.

In accordance with ARB 51, the Company presents the amount of subsidiary equity controlled by RTFC and NCSC as minority interest on the consolidated balance sheets and the subsidiary earnings controlled by RTFC and NCSC as minority interest on the consolidated statements of operations.

(c) Investments

The Company accounts for its investments in trading securities in accordance with Statement of Financial Accounting Standards ("SFAS") 115, Accounting for Certain Investments in Debt and Equity Securities ("SFAS 115"). The Company intends to sell these assets back into the marketplace as soon as practicable and at a reasonable price. Therefore, the Company classifies these assets as trading securities. Trading securities are carried at fair value with changes in fair value recorded in earnings.

The Company accounts for its investments in preferred stock under the cost method in accordance with Accounting Principles Board Opinion 18, The Equity Method of Accounting for Investments in Common Stock, as these investments do not meet the definition of a marketable security under SFAS 115. Under the cost method of accounting, the Company records the preferred stock at cost and recognizes as income dividends received that are earned from net accumulated earnings. Dividends received in excess of earnings subsequent to the date of investment are considered a return of investment and are recorded as reductions of cost of the investment. The Company continually monitors these investments for possible impairment. Other-than-temporary impairments are recognized in earnings.

(d) Allowance for Loan Losses

The Company maintains an allowance for loan losses at a level estimated by management to provide for probable losses inherent in the loan portfolio. These estimates are based upon a review of the composition of the loan portfolio, past loss experience, specific problem loans, current economic conditions and other pertinent factors which, in management's judgment, may contribute to expected losses. On a quarterly basis, the Company prepares an analysis of the loan loss allowance and makes adjustments to the allowance as necessary. The allowance is based on estimates and, accordingly, actual loan losses may differ from the allowance amount.

Management recommends to the board of directors of National Rural when a loan should be charged off. In making its recommendation to charge off all or a portion of a loan balance, management considers various factors including cash flow analysis and the value of the collateral securing the borrower's loans.

Activity in the loan loss allowance account is summarized below:

| | For the nine months ended and as of | | For the year ended and as of |
|---|--|-------------------------|--|
| (in thousands) | February 28, 2009 | February 29, 2008 | May 31, 2008 |
| Balance at beginning of period | \$ 514,906 | \$ 561,663 | \$561,663 |
| Provision for (recovery of) loan losses | 126,577 | (47,900) | (30,262) |
| Charge-offs | (3,173) | (16,827) | (16,911) |
| Recoveries | 273 | 324 | 416 |
| Balance at end of period | \$ 638,583 | \$ 497,260 | \$514,906 |

(e) Interest Income

The following table presents the components of interest income:

| (in thousands) | For the three months ended | | For the nine months ended | |
|---|----------------------------|-------------------------|---------------------------|-------------------------|
| | February 28, 2009 | February 29, 2008 | February 28, 2009 | February 29, 2008 |
| Interest on long-term fixed-rate loans (1) | \$ 220,791 | \$ 220,117 | \$ 669,454 | \$ 649,860 |
| Interest on long-term variable-rate loans (1) | 27,035 | 20,785 | 60,684 | 68,024 |
| Interest on short-term loans (1) | 18,208 | 20,224 | 58,654 | 59,816 |
| Interest on investments (2) | 990 | 1,832 | 4,615 | 6,668 |
| Conversion fees (3) | 1,355 | 1,587 | 4,594 | 5,096 |
| Make-whole and prepayment fees (4) | 203 | 533 | 1,070 | 2,287 |
| Commitment and guarantee fees (5) | 2,196 | 822 | 5,832 | 3,742 |
| Other fees | 655 | 676 | 2,090 | 2,324 |
| Total interest income | \$ 271,433 | \$ 266,576 | \$ 806,993 | \$ 797,817 |

(1) Represents interest income on loans to members.

(2) Represents interest income on the investment of cash and trading securities.

(3) Conversion fees are deferred and recognized using the 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.

(4) Make-whole and prepayment fees are charged for the early repayment of principal in full and recognized when collected.

(5) Commitment fees for RTFC loan commitments are, in most cases, refundable according to the amount of the loan commitment that is advanced. Such refundable fees are deferred and then recognized based on the portion of the loan that is not advanced prior to the expiration of the commitment. Commitment fees on National Rural loan commitments are not refundable and are billed and recognized based on the unused portion of committed lines of credit. Guarantee fees, including fees related to the Company's obligation to perform as liquidity provider, are deferred and amortized using the straight-line method into interest income over the life of the guarantee.

Deferred income on the consolidated balance sheets is comprised primarily of deferred conversion fees totaling \$16 million and \$20 million at February 28, 2009 and May 31, 2008, respectively.

(f) Interest Expense

The following table presents the components of interest expense:

| (in thousands) | For the three months ended | | For the nine months ended | |
|--|----------------------------|-------------------------|---------------------------|-------------------------|
| | February 28, 2009 | February 29, 2008 | February 28, 2009 | February 29, 2008 |
| Interest expense (1): | | | | |
| Commercial paper and bank bid notes | \$ 13,424 | \$ 30,639 | \$ 53,500 | \$ 102,117 |
| Medium-term notes | 80,503 | 82,555 | 242,016 | 249,422 |
| Collateral trust bonds | 80,110 | 61,213 | 211,065 | 189,968 |
| Subordinated deferrable debt | 4,916 | 4,916 | 14,747 | 14,747 |
| Subordinated certificates | 13,475 | 12,297 | 38,723 | 36,451 |
| Long-term private debt | 36,598 | 34,359 | 106,728 | 100,102 |
| Debt issuance costs (2) | 2,692 | 2,328 | 7,218 | 7,625 |
| Commitment and guarantee fees (3) | 5,871 | 4,602 | 15,884 | 13,277 |
| Loss on early extinguishment of debt (4) | - | - | - | 5,509 |
| Other fees | 2,527 | 559 | 4,768 | 1,592 |
| Total interest expense | \$ 240,116 | \$ 233,468 | \$ 694,649 | \$ 720,810 |

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

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

(3) Includes various fees related to funding activities, including fees paid to banks participating in the Company's revolving credit agreements and fees paid under bond guarantee agreements with RUS as part of the Rural Economic Development Loan and Grant program. Fees are recognized as incurred or amortized on a straight-line basis over the life of the respective agreement.

(4) Represents the loss on the early retirement of debt including the write-off of unamortized discount, premium and issuance costs.

The Company does not include indirect costs, if any, related to funding activities in interest expense.

(g) Comprehensive Income

Comprehensive income or loss includes the Company's net income (loss), as well as other comprehensive income resulting from a transition adjustment recorded upon the initial adoption of SFAS 133, Accounting for Derivative Financial Instruments and Hedging Activities, as amended ("SFAS 133"). Comprehensive income (loss) is calculated as follows:

| (in thousands) | For the three months ended | | For the nine months ended | |
|-------------------|----------------------------|-------------------------|---------------------------|-------------------------|
| | February 28, 2009 | February 29, 2008 | February 28, 2009 | February 29, 2008 |
| Net income (loss) | \$ 75,239 | \$ (323) | \$ (139,907) | \$ (41,931) |

Other comprehensive income:

| | | | | |
|--|-----------|----------|--------------|-------------|
| Reclassification adjustment for realized gain on derivatives | (159) | (256) | (558) | (587) |
| Comprehensive income (loss) | \$ 75,080 | \$ (579) | \$ (140,465) | \$ (42,518) |

(2) Loans and Commitments

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

| (in thousands) | February 28, 2009 | | May 31, 2008 | |
|---------------------------------|-------------------|----------------------------|-------------------|----------------------------|
| | Loans Outstanding | Unadvanced Commitments (1) | Loans Outstanding | Unadvanced Commitments (1) |
| Total by loan type (2) (3): | | | | |
| Long-term fixed-rate loans | \$ 14,707,739 | \$ - | \$ 15,204,614 | \$ - |
| Long-term variable-rate loans | 3,179,657 | 6,042,073 | 1,882,095 | 5,975,541 |
| Loans guaranteed by RUS | 245,015 | 491 | 250,169 | 491 |
| Short-term loans | 2,036,467 | 7,802,408 | 1,690,117 | 7,597,712 |
| Total loans outstanding | 20,168,878 | 13,844,972 | 19,026,995 | 13,573,744 |
| Deferred origination fees | 3,621 | - | 2,045 | - |
| Less: Allowance for loan losses | (638,583) | - | (514,906) | - |
| Net loans outstanding | \$ 19,533,916 | \$ 13,844,972 | \$ 18,514,134 | \$ 13,573,744 |
| Total by segment (2): | | | | |
| National Rural: | | | | |
| Distribution | \$ 13,845,609 | \$ 9,818,766 | \$ 13,438,370 | \$ 9,579,213 |
| Power supply | 4,114,046 | 3,107,598 | 3,339,112 | 2,960,693 |
| Statewide and associate | 94,317 | 156,778 | 108,925 | 158,293 |
| National Rural total | 18,053,972 | 13,083,142 | 16,886,407 | 12,698,199 |
| RTFC | 1,674,307 | 467,479 | 1,726,514 | 562,389 |
| NCSC | 440,599 | 294,351 | 414,074 | 313,156 |
| Total loans outstanding | \$ 20,168,878 | \$ 13,844,972 | 19,026,995 | \$ 13,573,744 |

(1) Unadvanced loan commitments include loans for which loan contracts have been approved and executed, but funds have not been advanced. Prior to advancing funds, additional information may be required to assure that all conditions for the advance of funds have been fully met and there has been no material change in the member's condition as represented in the supporting documents. Since commitments may expire without being fully drawn upon and a significant amount of the commitments are for standby liquidity purposes, the total unadvanced loan commitments do not necessarily represent National Rural's future cash requirements. Collateral and security requirements for advances on commitments are identical to those required at the time of the initial loan approval. Because the interest rate on unadvanced commitments is not set until drawn, long-term unadvanced loan commitments have been classified in this table as variable-rate unadvanced commitments. However, at the time of the advance, the borrower may select a fixed or a variable rate on the new loan.

(2) Table includes non-performing and restructured loans.

(3) Loans are classified as long-term or short-term based on their original maturity.

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

| (in thousands) | February 28, 2009 | | May 31, 2008 | |
|----------------|-------------------|------------|--------------|------------|
| | Loans | Unadvanced | Loans | Unadvanced |

| Non-performing and restructured loans: | Outstanding | Commitments (1) | Outstanding | Commitments (1) |
|--|-------------|--------------------|-------------|--------------------|
| Non-performing loans (2): | | | | |
| RTFC: | | | | |
| Long-term fixed-rate loans | \$ 8,960 | \$ - | \$ 219,912 | \$ - |
| Long-term variable-rate loans | 464,289 | - | 261,109 | - |
| Short-term loans | 25,045 | - | 25,843 | - |
| Total non-performing loans | \$ 498,294 | \$ - | \$ 506,864 | \$ - |
| Restructured loans (2): | | | | |
| National Rural: | | | | |
| Long-term fixed-rate loans | \$ 41,995 | \$ - | \$ 52,309 | \$ - |
| Long-term variable-rate loans | 497,935 | 186,673 | 519,257 | 186,673 |
| Short-term loans | - | 12,500 | - | 12,500 |
| National Rural total restructured loans | 539,930 | 199,173 | 571,566 | 199,173 |
| RTFC: | | | | |
| Long-term fixed-rate loans | 5,031 | - | 5,545 | - |
| Total restructured loans | \$ 544,961 | \$ 199,173 | \$ 577,111 | \$ 199,173 |

(1) Unadvanced loan commitments include loans for which loan contracts have been approved and executed, but funds have not been advanced. Prior to advancing funds, additional information may be required to assure that all conditions for the advance of funds have been fully met and there has been no material change in the member's condition as represented in the supporting documents. Since commitments may expire without being fully drawn upon and a significant amount of the commitments are for standby liquidity purposes, the total unadvanced loan commitments do not necessarily represent National Rural's future cash requirements. Collateral and security requirements for advances on commitments are identical to those required at the time of the initial loan approval. Because the interest rate on unadvanced commitments is not set until drawn, long-term unadvanced loan commitments have been classified in this table as variable-rate unadvanced commitments. However, at the time of the advance, the borrower may select a fixed or a variable rate on the new loan.

(2) Loans are classified as long-term or short-term based on their original maturity.

Loan origination costs are deferred and amortized using the straight-line method, which approximates the interest method, over the life of the loan as a reduction to interest income.

Loan Security

The Company evaluates each borrower's creditworthiness on a case-by-case basis. It is generally the Company's policy to require collateral for long-term loans. Such collateral usually consists of a first mortgage lien on the borrower's total assets, including plant and equipment, and a pledge of future revenues. The loan and security documents also contain various provisions with respect to the mortgaging of the borrower's property and debt service coverage ratios, maintenance of adequate insurance coverage as well as certain other restrictive covenants.

The following tables summarize the Company's secured and unsecured loans outstanding by loan type and by segment:

| (dollar amounts in thousands) | February 28, 2009 | | | | May 31, 2008 | | | |
|-------------------------------------|-------------------|-----|--------------|-----|--------------|-----|--------------|-----|
| | Secured | % | Unsecured | % | Secured | % | Unsecured | % |
| Total by loan type: | | | | | | | | |
| Long-term fixed-rate loans | 14,164,957 | 96 | 542,782 | 4 | 14,732,058 | 97% | \$ 472,556 | 3% |
| | \$ | % | \$ | % | \$ | % | \$ | % |
| Long-term variable-rate loans | 2,780,734 | 87 | 398,923 | 13 | 1,728,803 | 92 | 153,292 | 8 |
| Loans guaranteed by RUS | 245,015 | 100 | - | - | 250,169 | 100 | - | - |
| Short-term loans | 213,533 | 10 | 1,822,934 | 90 | 165,226 | 10 | 1,524,891 | 90 |
| Total loans | \$17,404,239 | 86 | \$ 2,764,639 | 14 | \$16,876,256 | 89 | \$ 2,150,739 | 11 |
| Total by segment: | | | | | | | | |
| National Rural | \$15,590,030 | 86% | \$ 2,463,942 | 14% | \$15,021,067 | 89% | \$ 1,865,340 | 11% |
| RTFC | 1,436,224 | 86 | 238,083 | 14 | 1,497,487 | 87 | 229,027 | 13 |
| NCSC | 377,985 | 86 | 62,614 | 14 | 357,702 | 86 | 56,372 | 14 |

| | | | | | | | | |
|-------|--------------|----|--------------|----|--------------|----|--------------|----|
| Total | \$17,404,239 | 86 | \$ 2,764,639 | 14 | \$16,876,256 | 89 | \$ 2,150,739 | 11 |
| loans | | | | | | | | |

Pledging of Loans

The following table summarizes the Company's collateral pledged to secure its collateral trust bonds and notes payable to the Federal Agricultural Mortgage Corporation ("Farmer Mac") and the amount of the corresponding debt outstanding:

| | February 28, 2009 | May 31, 2008 |
|------------------------------------|-------------------------|-----------------|
| (in thousands) | | |
| Collateral Trust Bonds: | | |
| 2007 indenture | | |
| Distribution system mortgage notes | \$4,340,578 | \$917,925 |
| Collateral trust bonds | 3,000,000 | 700,000 |
| 1994 indenture | | |
| Distribution system mortgage notes | \$ | |