

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	General Reserve	Patronage Capital Allocated 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	\$ 496	\$ 22,753
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	\$ 496	\$ 37,537
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	\$ 498	\$ 105,100
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	\$ 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 28, 2009	February 29, 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

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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
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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	\$	