

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORP /DC/
Form 10-Q
January 13, 2014

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended November 30, 2013

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 no.)

20701 Cooperative Way,
Dulles, Virginia
(Address of principal executive
offices)

20166
(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.

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(in thousands)

A S S E T S

	November 30, 2013	May 31, 2013
Cash and cash equivalents	\$ 301,377	\$ 177,062
Restricted cash	8,651	7,696
Investments	26,388	31,632
Time deposits	800,000	700,000
Loans to members	20,388,220	20,305,874
Less: Allowance for loan losses	(55,199)	(54,325)
Loans to members, net	20,333,021	20,251,549
Accrued interest and other receivables	205,084	175,183
Fixed assets, net	104,866	104,508
Debt service reserve funds	39,353	39,803
Debt issuance costs, net	41,457	38,949
Foreclosed assets, net	255,607	261,472
Derivative assets	291,757	257,878
Other assets	23,803	25,919
Total assets	\$ 22,431,364	\$ 22,071,651

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(in thousands)

LIABILITIES AND EQUITY

	November 30, 2013	May 31, 2013
Short-term debt	\$ 6,466,990	\$ 7,719,483
Accrued interest payable	134,150	144,945
Long-term debt	12,307,904	10,696,433
Deferred income	74,115	25,717
Derivative liabilities	397,695	475,278
Subordinated deferrable debt	400,000	400,000
Members' subordinated certificates:		
Membership subordinated certificates	644,757	644,757
Loan and guarantee subordinated certificates	690,390	696,719
Member capital securities	302,135	387,750
Total members' subordinated certificates	1,637,282	1,729,226
Other liabilities	64,492	69,308
Commitments and contingencies		
Total liabilities	21,482,628	21,260,390
CFC equity:		
Retained equity	930,424	791,090
Accumulated other comprehensive income	2,651	8,381
Total CFC equity	933,075	799,471
Noncontrolling interest	15,661	11,790
Total equity	948,736	811,261
Total liabilities and equity	\$ 22,431,364	\$ 22,071,651

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

(in thousands)

	For the three months ended November 30,		For the six months ended November 30,	
	2013	2012	2013	2012
Interest income	\$ 239,254	\$ 241,630	\$ 480,325	\$ 481,715
Interest expense	(165,345)	(174,301)	(332,930)	(350,897)
Net interest income	73,909	67,329	147,395	130,818
(Provision for) recovery of loan losses	(1,096)	3,817	(2,374)	(5,305)
Net interest income after (provision for) recovery of loan losses	72,813	71,146	145,021	125,513
Non-interest income:				
Fee and other income	5,125	17,807	9,281	22,765
Derivative (losses) gains	(30,780)	(3,766)	75,604	(28,358)
Results of operations of foreclosed assets	(3,269)	(909)	(7,318)	(5,674)
Total non-interest income	(28,924)	13,132	77,567	(11,267)
Non-interest expense:				
Salaries and employee benefits	(9,018)	(10,148)	(19,346)	(20,553)
Other general and administrative expenses	(9,555)	(9,303)	(17,842)	(16,068)
(Provision for) recovery of guarantee liability	(73)	92	(42)	101
Other	(150)	(4,384)	(298)	(4,547)
Total non-interest expense	(18,796)	(23,743)	(37,528)	(41,067)
Income prior to income taxes	25,093	60,535	185,060	73,179
Income tax expense	(101)	(454)	(1,802)	(452)
Net income	24,992	60,081	183,258	72,727
Less: Net income attributable to the noncontrolling interest	(67)	(699)	(2,785)	(704)

Net income attributable to CFC	\$	24,925	\$	59,382	\$	180,473	\$	72,023
--------------------------------	----	--------	----	--------	----	---------	----	--------

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (UNAUDITED)
 (in thousands)

	For the three months ended November 30,		For the six months ended November 30,	
	2013	2012	2013	2012
Net income	\$ 24,992	\$ 60,081	\$ 183,258	\$ 72,727
Other comprehensive (loss) income:				
Add: Unrealized (losses) gains on securities	(1,335)	893	(5,244)	887
Less: Realized gains on derivatives	(249)	(253)	(495)	(505)
Other comprehensive (loss) income	(1,584)	640	(5,739)	382
Total comprehensive income	23,408	60,721	177,519	73,109
Less: Total comprehensive income attributable to noncontrolling interest	(62)	(694)	(2,776)	(693)
Total comprehensive income attributable to CFC	\$ 23,346	\$ 60,027	\$ 174,743	\$ 72,416

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(UNAUDITED)

(in thousands)

For the six months ended November 30, 2013 and 2012

	Total	Noncontrolling interest	Total CFC equity	Accumulated other comprehensive income	CFC retained equity	Unallocated net income (loss)	Members' capital reserve	Patronage capital allocated	Members fees educ fu
Balance as of May 31, 2013	\$ 811,261	\$ 11,790	\$ 799,471	\$ 8,381	\$ 791,090	\$ (213,255)	\$ 410,259	\$ 591,581	\$
Patronage capital retirement	(40,724)	-	(40,724)	-	(40,724)	-	-	(40,724)	
Net income	183,258	2,785	180,473	-	180,473	180,473	-	-	
Other comprehensive loss	(5,739)	(9)	(5,730)	(5,730)	-	-	-	-	
Other	680	1,095	(415)	-	(415)	-	-	-	
Balance as of November 30, 2013	\$ 948,736	\$ 15,661	\$ 933,075	\$ 2,651	\$ 930,424	\$ (32,782)	\$ 410,259	\$ 550,857	\$
Balance as of May 31, 2012	\$ 490,755	\$ 7,592	\$ 483,163	\$ 9,199	\$ 473,964	\$ (346,941)	\$ 272,126	\$ 546,366	\$
Patronage capital retirement	(35,341)	-	(35,341)	-	(35,341)	-	-	(35,341)	
Net income	72,727	704	72,023	-	72,023	72,023	-	-	
Other comprehensive income (loss)	382	(11)	393	393	-	-	-	-	
Other	(367)	(2)	(365)	-	(365)	-	-	-	
Balance as of November 30, 2012	\$ 528,156	\$ 8,283	\$ 519,873	\$ 9,592	\$ 510,281	\$ (274,918)	\$ 272,126	\$ 511,025	\$

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

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

	For the six months ended November 30,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 183,258	\$ 72,727
Adjustments to reconcile net income to net cash provided by operating activities		
Amortization of deferred income	(6,104)	(4,710)
Amortization of debt issuance costs and deferred charges	3,647	3,842
Amortization of discount on long-term debt	2,367	-
Amortization of issuance costs for revolving bank lines of credit	1,332	-
Depreciation	2,838	2,625
Provision for loan losses	2,374	5,305
Provision for (recovery of) guarantee liability	42	(101)
Results of operations of foreclosed assets	7,318	5,674
Derivative forward value	(111,760)	(961)
Changes in operating assets and liabilities:		
Accrued interest and other receivables	(30,795)	13,386
Accrued interest payable	(10,795)	(6,329)
Deferred income	54,502	-
Other	(3,665)	4,921
Net cash provided by operating activities	94,559	96,379
CASH FLOWS FROM INVESTING ACTIVITIES		
Advances made on loans	(3,941,276)	(2,486,149)
Principal collected on loans	3,859,164	2,300,104
Net investment in fixed assets	(3,196)	(2,961)
Proceeds from foreclosed assets	8,567	29,110
Investments in foreclosed assets	(10,020)	(57,111)
Time deposit investments	(100,000)	(250,000)
Change in restricted cash	(955)	(955)
Net cash used in investing activities	(187,716)	(467,962)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuances of short-term debt, net	64,751	90,853
Proceeds from issuances of short term debt with original maturity greater than 90 days	468,142	322,406

Repayments of short term debt with original maturity greater than 90 days	(324,820)	(198,172)
Issuance costs for revolving bank lines of credit	(2,751)	(1,447)
Issuance costs for subordinated deferrable debt	(150)	-
Proceeds from issuance of long-term debt	1,769,662	1,254,167
Payments for retirement of long-term debt	(1,713,395)	(730,293)
Proceeds from issuance of members' subordinated certificates	1,608	55,548
Payments for retirement of members' subordinated certificates	(5,945)	(6,066)
Payments for retirement of patronage capital	(39,630)	(33,991)
Cash paid portion of debt exchange premium	-	(133,406)
Net cash provided by financing activities	217,472	619,599
NET INCREASE IN CASH AND CASH EQUIVALENTS	124,315	248,016
BEGINNING CASH AND CASH EQUIVALENTS	177,062	191,167
ENDING CASH AND CASH EQUIVALENTS	\$ 301,377	\$ 439,183

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

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

	For the six months ended November 30,	
	2013	2012
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	\$ 336,379	\$ 353,383
Cash paid for income taxes	152	89
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.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

(1) General Information and Accounting Policies

(a) Basis of Presentation

The accompanying financial statements include the consolidated accounts of National Rural Utilities Cooperative Finance Corporation (“CFC”), Rural Telephone Finance Cooperative (“RTFC”), 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. 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.

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.

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 November 30, 2013, CFC had guaranteed \$82 million of NCSC debt, derivative instruments and guarantees with third parties, and CFC's maximum potential exposure for these instruments totaled \$89 million. The maturities for NCSC obligations guaranteed by CFC run 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 November 30, 2013, CFC guaranteed \$2 million of RTFC guarantees with third parties. The maturities for RTFC obligations guaranteed by CFC run 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. At November 30, 2013, RTFC had total assets of \$583 million including loans outstanding to members of \$467 million, and NCSC had total assets of \$757 million including loans outstanding of \$732 million. At November 30, 2013, CFC had committed to lend RTFC

up to \$4,000 million, of which \$447 million was outstanding. At November 30, 2013, CFC had committed to provide up to \$3,000 million of credit to NCSC, of which \$799 million was outstanding, representing \$717 million of outstanding loans and \$82 million of credit enhancements.

(c) Loan Sales

We account for the sale of loans resulting from direct loan sales to third parties and securitization transactions by removing the financial assets 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 the calculation of 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 six months ended November 30, 2013 and 2012, we sold CFC loans with outstanding balances totaling \$37 million and \$98 million, respectively, at par for cash. We recorded a loss on sale of loans, representing the unamortized deferred loan origination costs and transaction costs for the loans sold, which was immaterial during the six months ended November 30, 2013 and 2012.

(d) Interest Income

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

(dollar amounts in thousands)	For the three months ended November 30,		For the six months ended November 30,	
	2013	2012	2013	2012
Interest on long-term fixed-rate loans	\$ 221,952	\$ 218,247	\$ 446,535	\$ 436,187
Interest on long-term variable-rate loans	4,826	4,893	9,654	10,918
Interest on line of credit loans	7,505	7,413	15,077	15,105
Interest on restructured loans	-	7,625	136	13,087
Interest on investments	1,817	1,576	3,753	2,514
Fee income (1)	3,154	1,876	5,170	3,904
Total interest income	\$ 239,254	\$ 241,630	\$ 480,325	\$ 481,715

(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 on the condensed consolidated balance sheets primarily includes deferred conversion fees totaling \$69 million and \$21 million at November 30, 2013 and May 31, 2013, respectively.

(e) Interest Expense

The following table presents the components of interest expense:

(dollar amounts in thousands)	For the three months ended November 30,		For the six months ended November 30,	
	2013	2012	2013	2012
Interest expense on debt (1):				
Short-term debt	\$ 1,607	\$ 1,697	\$ 3,039	\$ 3,316
Medium-term notes	20,980	24,833	42,551	52,716
Collateral trust bonds	74,858	82,271	151,656	163,710
Subordinated deferrable debt	4,750	2,807	9,500	5,613
Subordinated certificates	20,494	20,528	41,120	40,882
Long-term notes payable	38,759	37,915	76,698	76,311
Debt issuance costs (2)	1,782	1,905	3,647	3,842
Fee expense (3)	2,115	2,345	4,719	4,507
Total interest expense	\$ 165,345	\$ 174,301	\$ 332,930	\$ 350,897

(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 transactions that receive hedge accounting treatment. If applicable hedge accounting criteria are satisfied, the change in fair value of derivative instruments is recorded to 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 amortized as 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) Reclassifications

Reclassifications of prior period amounts have been made to conform to the current reporting format and the presentation in our Form 10-Q for the six months ended November 30, 2013. Specifically, time deposits with financial institutions have been reclassified from the investments line item and presented as a separate line item on the condensed consolidated balance sheet as of May 31, 2013.

(h) Immaterial Correction of Errors

During the third quarter of fiscal year 2013, we identified two errors in the condensed consolidated statement of cash flows related to (1) the classification of advances and sale proceeds of loans sold and (2) the presentation of short-term debt with an original maturity of greater than 90 days. We corrected our previously reported condensed consolidated statement of cash flows for the six months ended November 30, 2012 herein to reflect the impact of the immaterial errors. The errors and the corrections have no effect on the change in cash, our total cash balance, liquidity, condensed consolidated balance sheet, condensed consolidated statement of operations, key ratios or covenant compliance for any period. We concluded that the errors were not material to any of the previously reported quarterly or annual periods.

The effect of recording the correction of the immaterial errors in the condensed consolidated statement of cash flows for the six months ended November 30, 2012, is presented below:

For the six months ended November 30, 2012

(dollar amounts in thousands)	As Filed	Adjustment	Corrected
Advances made on loans	\$(2,584,296)	\$ 98,147	\$(2,486,149)
Net proceeds from sale of loans	98,147	(98,147)	-
Proceeds from issuances of short-term debt, net	215,087	(124,234)	90,853
Proceeds from issuances of short term debt with original maturity greater than 90 days	-	322,406	322,406
Repayments of short term debt with original maturity greater than 90 days	-	(198,172)	(198,172)

(i) 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 the Company 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 the Company 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) Investments

Our investments include Federal Agricultural Mortgage Corporation Series A preferred stock with a cost basis of \$30 million and fair value of \$24 million and \$29 million at November 30, 2013 and May 31, 2013, respectively, and an unrealized loss of \$6 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. Management does not intend to sell this investment in the foreseeable future and believes the decline is temporary. 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 \$2.3 million and \$2.2 million at November 30, 2013 and May 31, 2013, respectively, and an unrealized gain of \$1.8 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:

	November 30, 2013		May 31, 2013	
	Loans outstanding	Unadvanced commitments (1)	Loans outstanding	Unadvanced commitments (1)
(dollar amounts in thousands)				
Total by loan type (2):				
Long-term fixed-rate loans	\$ 18,149,347	\$ -	\$ 17,918,268	\$ -
Long-term variable-rate loans	691,568	5,134,559	782,006	4,718,162
Loans guaranteed by RUS	204,465	-	210,815	-
Line of credit loans	1,333,050	8,880,648	1,385,228	8,704,586
Total loans outstanding	20,378,430	14,015,207	20,296,317	13,422,748
Deferred origination costs	9,790	-	9,557	-
Less: Allowance for loan losses	(55,199)	-	(54,325)	-
Net loans outstanding	\$ 20,333,021	\$ 14,015,207	\$ 20,251,549	\$ 13,422,748

Total by member class (2):

CFC:

Distribution	\$ 15,019,692	\$ 9,414,509	\$ 14,941,192	\$ 8,948,826
Power supply	4,094,415	3,133,967	4,007,669	3,145,518
Statewide and associate	65,207	107,493	70,956	102,087
CFC total	19,179,314	12,655,969	19,019,817	12,196,431
RTFC	466,863	305,649	503,359	317,344
NCSC	732,253	1,053,589	773,141	908,973
Total loans outstanding	\$ 20,378,430	\$ 14,015,207	\$ 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 non-performing and restructured loans.

Non-performing and restructured loans outstanding and unadvanced commitments to members included in the table on page 12 are summarized as follows by loan type and by company:

(dollar amounts in thousands)	November 30, 2013		May 31, 2013	
	Loans outstanding	Unadvanced commitments (1)	Loans outstanding	Unadvanced commitments (1)
Non-performing and restructured loans:				
Non-performing loans:				
CFC:				
Line of credit loans	\$ 5,000	\$ -	\$ 5,000	\$ -
RTFC:				
Long-term fixed-rate loans	3,010	-	3,690	-
Long-term variable-rate loans	2,784	-	6,807	-
Total non-performing loans	\$ 10,794	\$ -	\$ 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 \$1,948 million and \$1,703 million of unadvanced commitments at November 30, 2013 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 under committed lines of credit that are not subject to a material adverse change clause at November 30, 2013, and the related maturities by fiscal year and thereafter as follows:

(dollar amounts in thousands)	Available balance	Notional maturities of committed lines of credit					Thereafter
		2014	2015	2016	2017	2018	
Committed lines of credit	\$ 1,947,800	\$ 44,048	\$ 63,776	\$ 61,000	\$ 636,111	\$ 894,080	\$ 248,785

The remaining unadvanced commitments totaling \$12,067 million and \$11,720 million at November 30, 2013 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 show an analysis of the age of the recorded investment in loans outstanding by member class:

(dollar amounts in thousands)	November 30, 2013					
	30-89 days past due	90 days or more past due (1)	Total past due	Current	Total financing receivables	Non-accrual loans
CFC:						
Distribution	\$ -	\$ -	\$ -	\$ 15,019,692	\$ 15,019,692	\$ 7,584
Power supply	-	5,000	5,000	4,089,415	4,094,415	5,000
Statewide and associate	-	-	-	65,207	65,207	-
CFC total	-	5,000	5,000	19,174,314	19,179,314	12,584
RTFC	-	3,858	3,858	463,005	466,863	5,794
NCSC	-	-	-	732,253	732,253	-
Total loans outstanding	\$ -	\$ 8,858	\$ 8,858	\$ 20,369,572	\$ 20,378,430	\$ 18,378
As a % of total loans	0.00%	0.04%	0.04%	99.96%	100.00%	0.09%

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

(dollar amounts in thousands)	May 31, 2013					
	30-89 days past due	90 days or more past due (1)	Total past due	Current	Total financing receivables	Non-accrual loans
CFC:						
Distribution	\$ 2,841	\$ -	\$ 2,841	\$ 14,938,351	\$ 14,941,192	\$ 7,584
Power supply	-	5,000	5,000	4,002,669	4,007,669	5,000
Statewide and associate	-	-	-	70,956	70,956	-
CFC total	2,841	5,000	7,841	19,011,976	19,019,817	12,584
RTFC	4,163	4,156	8,319	495,040	503,359	10,497
NCSC	-	-	-	773,141	773,141	-
Total loans outstanding	\$ 7,004	\$ 9,156	\$ 16,160	\$ 20,280,157	\$ 20,296,317	\$ 23,081
As a % of total loans	0.03%	0.05%	0.08%	99.92%	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 based on available data as of:

(dollar amounts in thousands)	November 30, 2013			May 31, 2013		
	Pass	Criticized	Total	Pass	Criticized	Total
CFC:						
Distribution	\$ 15,001,056	\$ 18,636	\$ 15,019,692	\$ 14,922,558	\$ 18,634	\$ 14,941,192
Power supply	4,089,415	5,000	4,094,415	4,002,669	5,000	4,007,669
Statewide and associate	64,924	283	65,207	70,668	288	70,956
CFC total	19,155,395	23,919	19,179,314	18,995,895	23,922	19,019,817
RTFC	450,668	16,195	466,863	483,058	20,301	503,359
NCSC	728,482	3,771	732,253	770,419	2,722	773,141
Total loans outstanding	\$ 20,334,545	\$ 43,885	\$ 20,378,430	\$ 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:

(dollar amounts in thousands)	November 30, 2013				May 31, 2013			
	Secured	%	Unsecured	%	Secured	%	Unsecured	%
Total by loan type:								
Long-term fixed-rate loans	\$ 17,089,122	94%	\$ 1,060,225	6%	\$ 16,871,594	94%	\$ 1,046,674	6%
Long-term variable-rate loans	607,643	88	83,925	12	676,075	86	105,931	14
Loans guaranteed by RUS	204,465	100	-	-	210,815	100	-	-
Line of credit loans	303,417	23	1,029,633	77	294,575	21	1,090,653	79
Total loans outstanding	\$ 18,204,647	89	\$ 2,173,783	11	\$ 18,053,059	89	\$ 2,243,258	11
Total by company:								
CFC	\$ 17,243,451	90%	\$ 1,935,863	10%	\$ 17,049,029	90%	\$ 1,970,788	10%
RTFC	446,007	96	20,856	4	482,647	96	20,712	4
NCSC	515,189	70	217,064	30	521,383	67	251,758	33
Total loans outstanding	\$ 18,204,647	89	\$ 2,173,783	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 activity in the loan loss allowance summarized in the tables below reflects a disaggregation by company of the allowance for loan losses by company:

		As of and for the three months ended November 30, 2013			
(dollar amounts in thousands)		CFC	RTFC	NCSC	Total
Balance as of August 31, 2013	\$	43,336	\$ 8,497	\$ 3,823	\$ 55,656
(Recovery of) provision for loan losses		(627)	968	755	1,096
Charge-offs		-	(1,606)	-	(1,606)
Recoveries of loans previously charged-off		53	-	-	53
Balance as of November 30, 2013	\$	42,762	\$ 7,859	\$ 4,578	\$ 55,199

		As of and for the three months ended November 30, 2012			
(dollar amounts in thousands)		CFC	RTFC	NCSC	Total
Balance as of August 31, 2012	\$	136,781	\$ 8,877	\$ 6,843	\$ 152,501
(Recovery of) provision for loan losses		(3,256)	(563)	2	(3,817)
Recoveries of loans previously charged-off		53	-	-	53
Balance as of November 30, 2012	\$	133,578	\$ 8,314	\$ 6,845	\$ 148,737

As of and for the six months ended November 30, 2013				
(dollar amounts in thousands)	CFC	RTFC	NCSC	Total
Balance as of May 31, 2013	\$ 41,246	\$ 9,158	\$ 3,921	\$ 54,325
Provision for loan losses	1,410	307	657	2,374
Charge-offs	-	(1,606)	-	(1,606)
Recoveries of loans previously charged-off	106	-	-	106
Balance as of November 30, 2013	\$ 42,762	\$ 7,859	\$ 4,578	\$ 55,199

As of and for the six months ended November 30, 2012				
(dollar amounts 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	6,531	(248)	(978)	5,305
Recoveries of loans previously charged-off	106	-	-	106
Balance as of November 30, 2012	\$ 133,578	\$ 8,314	\$ 6,845	\$ 148,737

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:

November 30, 2013				
(dollar amounts in thousands)	CFC	RTFC	NCSC	Total
Ending balance of the allowance:				
Collectively evaluated	\$ 42,762	\$ 6,041	\$ 4,578	\$ 53,381
Individually evaluated	-	1,818	-	1,818
Total ending balance of the allowance	\$ 42,762	\$ 7,859	\$ 4,578	\$ 55,199

Recorded investment in loans:				
Collectively evaluated	\$ 19,166,730	\$ 461,069	\$ 732,253	\$ 20,360,052
Individually evaluated	12,584	5,794	-	18,378
Total recorded investment in loans	\$ 19,179,314	\$ 466,863	\$ 732,253	\$ 20,378,430

Loans to members, net (1)	\$ 19,136,552	\$ 459,004	\$ 727,675	\$ 20,323,231
---------------------------	---------------	------------	------------	---------------

May 31, 2013				
(dollar amounts 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	\$ 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 November 30, 2013 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:

(dollar amounts in thousands)	November 30, 2013		May 31, 2013	
	Recorded investment	Related allowance	Recorded investment	Related allowance
With no specific allowance recorded:				
CFC/Distribution	\$ 7,584	\$ -	\$ 46,953	\$ -
CFC/Power Supply	5,000	-	5,000	-
Total	12,584	-	51,953	-
With a specific allowance recorded:				
RTFC	5,794	1,818	10,497	3,427
Total	5,794	1,818	10,497	3,427
Total impaired loans	\$ 18,378	\$ 1,818	\$ 62,450	\$ 3,427

The recorded investment for impaired loans was equal to the total unpaid principal balance for impaired loans as of November 30, 2013 and May 31, 2013. The table below represents the average recorded investment in impaired loans and the interest income recognized by member class:

(dollar amounts in thousands)	For the three months ended November 30,			
	2013	2012	2013	2012
	Average recorded investment		Interest income recognized	
CFC/Distribution	\$ 7,584	\$ 70,706	\$ -	\$ 7,625
CFC/Power Supply	5,000	5,000	-	-
RTFC	7,295	6,618	-	-
Total impaired loans	\$ 19,879	\$ 82,324	\$ -	\$ 7,625

(dollar amounts in thousands)	For the six months ended November 30,			
	Average recorded investment		Interest income recognized	
	2013	2012	2013	2012
CFC/Distribution	\$ 14,116	\$ 277,891	\$ 136	\$ 13,087
CFC/Power Supply	5,000	5,000	-	-
RTFC	8,838	6,754	-	-
Total impaired loans	\$ 27,954	\$ 289,645	\$ 136	\$ 13,087

Non-performing and Restructured Loans

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

(dollar amounts in thousands)	For the three months ended November 30,		For the six months ended November 30,	
	2013	2012	2013	2012

Non-performing loans	\$	142	\$	373	\$	321	\$	780
Restructured loans		122		-		244		-
Total	\$	264	\$	373	\$	565	\$	780

At November 30, 2013 and May 31, 2013, non-performing loans totaled \$11 million or 0.1 percent, of loans outstanding and \$15 million or 0.1 percent, of loans outstanding, respectively. One borrower in this group is currently in bankruptcy. The members of the borrower filed a disclosure statement and draft plan of liquidation on October 18, 2013. Certain secured noteholders filed a disclosure statement and draft plan of reorganization on December 17, 2013. Each disclosure statement and plan is subject to certain changes, approval of the bankruptcy court and voting by impaired creditors. A status conference and hearing on both disclosure statements is scheduled for January 14, 2014. Another borrower in this group is contesting a ruling that it is required to repay state Universal Service Fund (“USF”) payments received. 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 November 30, 2013 and May 31, 2013, we had restructured loans totaling \$8 million, or 0.04 percent, of loans outstanding and \$47 million, or 0.2 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 November 30, 2013 compared to \$8 million of interest income during the prior-year period. Approximately \$0.1 million of interest income was accrued on restructured loans during the six months ended November 30, 2013, compared with \$13 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 November 30, 2013. This loan was on accrual status since the time of restructuring. At November 30, 2013, all restructured loans were on non-accrual status.

We believe our allowance for loan loss is adequate to cover the losses inherent in our loan portfolio at November 30, 2013.

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).

(dollar amounts in thousands)	November 30,	
	2013	May 31, 2013
Collateral trust bonds:		
2007 indenture		
Distribution system mortgage notes	\$ 5,536,853	\$ 5,674,804
RUS guaranteed loans qualifying as permitted investments	163,630	165,823
Total pledged collateral	\$ 5,700,483	\$ 5,840,627
Collateral trust bonds outstanding	4,579,372	4,679,372
1994 indenture		
Distribution system mortgage notes	\$ 1,599,727	\$ 1,641,858
Collateral trust bonds outstanding	1,460,000	1,465,000
Federal Agricultural Mortgage Corporation:		
Distribution and power supply system mortgage notes	\$ 1,693,828	\$ 1,795,947
Notes payable outstanding	1,529,286	1,542,474
Clean Renewable Energy Bonds Series 2009A:		
Distribution and power supply system mortgage notes	\$ 22,467	\$ 23,536
Cash	8,651	7,634
Total pledged collateral	\$ 31,118	\$ 31,170
Notes payable outstanding	19,888	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:

(dollar amounts in thousands)	November 30,	
	2013	May 31, 2013
Federal Financing Bank		
Distribution and power supply system mortgage notes on deposit	\$ 4,453,299	\$ 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 are subsequently evaluated periodically for impairment. These assets are classified on the condensed consolidated balance sheets as foreclosed assets. At November 30, 2013, all foreclosed assets were held by DRP and CAH, which are wholly-owned subsidiaries of CFC.

The activity for foreclosed assets is summarized below:

(dollar amounts in thousands)	As of and for the six months ended November 30, 2013		
	CAH	DRP	Total
Balance as of May 31, 2013	\$ 248,049	\$ 13,423	\$ 261,472
Results of operations	(6,651)	(667)	(7,318)
Cash investments (proceeds)	5,953	(4,500)	1,453
Balance as of November 30, 2013	\$ 247,351	\$ 8,256	\$ 255,607

During the six months ended November 30, 2013, our investment in the DRP foreclosed assets decreased primarily due to net cash proceeds received of \$4 million from the sale of raw land and developed lots.

(5) Short-Term Debt and Credit Arrangements

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

	November 30, 2013	May 31, 2013
(dollar amounts in thousands)		
Short-term debt:		
Commercial paper sold through dealers, net of discounts (1)	\$ 1,876,868	\$ 2,009,884
Commercial paper sold directly to members, at par (1)	1,011,155	812,141
Commercial paper sold directly to non-members, at par (1)	25,006	39,298
Select notes	588,590	358,390
Daily liquidity fund notes sold directly to members	606,586	680,419
Bank bid notes	150,000	150,000
Subtotal short-term debt	4,258,205	4,050,132
Long-term debt maturing within one year:		
Medium-term notes sold through dealers	607,472	989,607
Medium-term notes sold to members	416,998	391,318
Secured collateral trust bonds	604,994	1,504,949
Loan and guarantees subordinated certificates	37,827	37,176
Member capital securities	85,615	-
Secured notes payable	451,972	742,402
Unsecured notes payable	3,907	3,899
Total long-term debt maturing within one year	2,208,785	3,669,351
Total short-term debt	\$ 6,466,990	\$ 7,719,483

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

Revolving Credit Agreements

At November 30, 2013 and May 31, 2013, we had \$3,345 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 November 30, 2013, 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:

(dollar amounts in thousands)	Total available		Letters of credit outstanding		Maturity	Facility fee per year (1)
	November 30, 2013	May 31, 2013	November 30, 2013	May 31, 2013		
Three-year agreement	\$ 219,000	\$ 219,000	\$ -	\$ -	March 21, 2014	15 basis points
Three-year agreement	1,006,000	916,000	-	-	October 28, 2016	10 basis points
Four-year agreement	1,087,500	1,007,500	-	-	October 28, 2017	10 basis points
Five-year agreement	1,030,609	954,012	1,891	3,488	October 28, 2018	10 basis points
Total	\$ 3,343,109	\$ 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 to October 28, 2016, 2017 and 2018, respectively. The other terms of the facilities remain unchanged.

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

	Requirement	Actual November 30, 2013	Actual May 31, 2013
Minimum average adjusted TIER over the six most recent fiscal quarters (1)	1.025	1.27	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	5.74	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 November 30, 2013 and May 31, 2013, we were in compliance with all covenants and conditions 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:

	November 30, 2013	May 31, 2013
(dollar amounts in thousands)		
Unsecured long-term debt:		
Medium-term notes sold through dealers \$	1,780,416	\$ 1,528,424
Medium-term notes sold to members	143,280	182,790
Subtotal	1,923,696	1,711,214
Unamortized discount	(620)	(627)
Total unsecured medium-term notes	1,923,076	1,710,587
Unsecured notes payable	4,034,075	3,709,074
Unamortized discount	(845)	(920)
Total unsecured notes payable	4,033,230	3,708,154
Total unsecured long-term debt	5,956,306	5,418,741
Secured long-term debt:		
Collateral trust bonds	5,434,372	4,639,372
Unamortized discount	(179,976)	(181,640)
Total secured collateral trust bonds	5,254,396	4,457,732
Secured notes payable	1,097,202	819,960

Total secured long-term debt	6,351,598	5,277,692
Total long-term debt	\$ 12,307,904	\$ 10,696,433

In June 2013, we issued \$400 million of 2.35 percent collateral trust bonds due 2020 and 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 \$1.4 million will be recorded during the third quarter of fiscal 2014.

At November 30, 2013 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 six months ended November 30, 2013, 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. In the aggregate at November 30, 2013, we had up to \$924 million available under committed loan facilities from the Federal Financing Bank as part of this program.

At November 30, 2013 and May 31, 2013, secured notes payable include \$--1,529 million and \$1,542 million, respectively, in debt outstanding to the Federal Agricultural Mortgage Corporation under a note purchase agreement totaling \$3,900 million. 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. At November 30, 2013 and May 31, 2013, \$450 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.

(7) Subordinated Deferrable Debt

At November 30, 2013 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 for forecasted transactions to mitigate interest rate risk.

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

(dollar amounts in thousands)	Notional amount	November 30, 2013		Notional amount	May 31, 2013	
		Weighted-average rate paid	Weighted-average rate received		Weighted-average rate paid	Weighted-average rate received
Pay fixed- variable	\$ 5,446,222	3.35%	0.23%	\$ 5,287,889	3.39%	0.26%
Pay variable- receive		0.95	4.06		1.12	4.62
fixed	2,925,440			3,500,440		
Total interest rate swaps	\$ 8,371,662	2.51	1.57	\$ 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:

(dollar amounts in thousands)	For the three months ended November 30,		For the six months ended November 30,	
	2013	2012	2013	2012
Derivative cash settlements	\$ (19,471)	\$ (15,456)	\$ (36,156)	\$ (29,319)
Derivative forward value	(11,309)	11,690	111,760	961
	\$ (30,780)	\$ (3,766)	\$ 75,604	\$ (28,358)

Derivative (losses)
gains

Rating Triggers

Some of our interest rate swaps have credit risk-related contingent features referred to as rating triggers. Rating triggers are not separate financial instruments and are not required to be accounted for separately as derivatives. At November 30, 2013, the following notional amounts of derivative instruments had rating triggers based on our senior unsecured credit ratings from Moody's Investors Service or Standard & Poor's Corporation falling to a level specified in the applicable agreements and are grouped into the categories below. In calculating the payments and collections required upon termination, we netted the agreements for each counterparty, as allowed by the underlying master agreements. At November 30, 2013, our senior unsecured credit ratings from Moody's Investors Service and Standard & Poor's Corporation were A2 and A, respectively. At November 30, 2013, both Moody's Investors Service and Standard & Poor's Corporation had our ratings on stable outlook.

(dollar amounts in thousands)	Notional amount	Our required payment	Amount we would collect	Net total
Mutual rating trigger if ratings:				
fall to Baa1/BBB+ (1)	\$ 1,500	\$ (40)	\$ -	\$ (40)
fall below Baa1/BBB+ (1)	6,627,731	(162,986)	88,745	(74,241)
Total	\$ 6,629,231	\$ (163,026)	\$ 88,745	\$ (74,281)

(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 on page 21, at November 30, 2013, we had a total notional amount of \$450 million of derivative instruments with one counterparty that would require the pledging of collateral totaling \$11 million (the fair value of such derivative instruments excluding credit risk) if our senior unsecured ratings from Moody's Investors Service were to fall below Baa2 or if the ratings from Standard & Poor's Corporation were to fall below BBB. The aggregate fair value of all interest rate swaps with rating triggers that were in a net liability position at November 30, 2013, including credit risk, was \$171 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.

November 30, 2013						
(dollar amounts in thousands)	Gross amounts of recognized assets/liabilities	Gross amounts offset in the condensed consolidated balance sheets	Net amounts of assets/liabilities presented in the condensed consolidated balance sheets	Gross amounts not offset in the condensed consolidated balance sheets		
				Financial instruments	Cash collateral pledged	Net amount
Assets:						
Derivatives -						
Interest rate swaps	\$ 291,757	\$ -	\$ 291,757	\$ 212,917	\$ -	\$ 78,840
Liabilities:						
Derivatives -						
Interest rate swaps	397,695	-	397,695	212,917	-	184,778

May 31, 2013						
(dollar amounts in thousands)	Gross amounts of recognized assets/liabilities	Gross amounts offset in the condensed consolidated balance sheets	Net amounts of assets/liabilities presented in the condensed consolidated balance sheets	Gross amounts not offset in the condensed consolidated balance sheets		
				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:

(dollar amounts in thousands)	November	
	30, 2013	May 31, 2013
Total by type:		
Long-term tax-exempt bonds	\$ 526,990	\$ 547,970
Letters of credit	451,594	447,683
Other guarantees	115,645	117,118
Total	\$ 1,094,229	\$ 1,112,771
Total by member class:		
CFC:		
Distribution	\$ 224,521	\$ 245,265
Power supply	813,891	810,900
Statewide and associate	5,397	6,948
CFC total	1,043,809	1,063,113
RTFC	2,304	3,711
NCSC	48,116	45,947
Total	\$ 1,094,229	\$ 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 November 30, 2013, our maximum potential exposure for the \$74 million of fixed-rate tax-exempt bonds is \$121 million, representing principal and interest. Of the amounts shown in the table above for long-term tax-exempt bonds, \$453 million and \$473 million as of November 30, 2013 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 \$161 million is secured at November 30, 2013. 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 November 30, 2013, we may be required to issue up to an additional \$172 million in letters of credit to third parties for the benefit of our members. As of November 30, 2013, all of our master letter of credit facilities were subject to material adverse change clauses at the time of issuance. Also, at November 30, 2013 we had hybrid letter of credit facilities totaling \$1,371 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 \$352 million at November 30, 2013. 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 \$1,019 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 \$117 million, all of which is unsecured.

At November 30, 2013 and May 31, 2013, we had \$406 million and \$410 million of guarantees, respectively, representing 37 percent of total guarantees for each period, under which our right of recovery from our members was not secured.

At November 30, 2013, we were the liquidity provider for a total of \$578 million of variable-rate tax-exempt bonds issued for our member cooperatives. As liquidity provider on these \$578 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 \$453 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 on page 23 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 six months ended November 30, 2013, we were not required to perform as liquidity provider pursuant to these obligations.

Guarantee Liability

At November 30, 2013 and May 31, 2013, we recorded a guarantee liability of \$24 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 November 30, 2013 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 \$22 million and \$23 million, respectively, at November 30, 2013 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:

	As of and for the six months ended November 30, 2013
(dollar amounts in thousands)	
Beginning balance as of May 31, 2013	\$ 24,742
Net change in non-contingent liability	(850)
Provision for contingent guarantee liability	42
Ending balance as of November 30, 2013	\$ 23,934
Liability as a percentage of total guarantees	2.19%

(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 November 30, 2013 and May 31, 2013 consisted of investments in common stock and preferred stock, derivative instruments, and collateral-dependent non-performing 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 six months ended November 30, 2013 we recorded an unrealized loss of \$1 million and \$5 million, respectively, compared to an unrealized gain of \$1 million 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:

(dollar amounts in thousands)	November 30, 2013		May 31, 2013	
	Level 1	Level 2	Level 1	Level 2
Derivative assets	\$ -	\$ 291,757	\$ -	\$ 257,878
Derivative liabilities	-	397,695	-	475,278
Investments in common and preferred stock	26,388	-	31,632	-
Deferred compensation investments	4,169	-	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 November 30, 2013 and May 31, 2013, we measured certain collateral-dependent non-performing 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 non-performing 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 November 30, 2013 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 six months ended November 30, 2013 and 2012, respectively,

there were no losses on our non-performing loans. The following table provides the carrying/fair value of the related individual assets at November 30, 2013 and May 31, 2013:

(dollar amounts in thousands)	Level 3 Fair Value	
	November 30, 2013	May 31, 2013
Non-performing loans, net of specific reserves	\$ 8,976	\$ 12,070

(12) Fair Value of Financial Instruments

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

(dollar amounts in thousands)	November 30, 2013		May 31, 2013	
	Carrying value	Fair value	Carrying value	Fair value
Assets:				
Cash and cash equivalents	\$ 301,377	\$ 301,377	\$ 177,062	\$ 177,062
Restricted cash	8,651	8,651	7,696	7,696
Investments	26,388	26,388	31,632	31,632
Time deposits	800,000	800,000	700,000	700,000
Deferred compensation investments	4,169	4,169	3,716	3,716
Loans to members, net	20,333,021	20,746,388	20,251,549	21,318,406
Debt service reserve funds	39,353	39,353	39,803	39,803
Derivative instruments	291,757	291,757	257,878	257,878
Liabilities:				
Short-term debt	6,466,990	6,480,895	7,719,483	7,751,021
Long-term debt	12,307,904	13,443,765	10,696,433	12,156,097
Guarantee liability	23,934	26,862	24,742	27,730
Derivative instruments	397,695	397,695	475,278	475,278
Subordinated deferrable debt	400,000	375,532	400,000	404,300
Members' subordinated certificates	1,637,282	1,754,549	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 six months ended November 30, 2013 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 November 30, 2013 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 November 30, 2013 and May 31, 2013, cash and cash equivalents classified within Level 1 of the fair value hierarchy totaled \$301 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 November 30, 2013 and May 31, 2013, restricted cash classified within Level 1 of the fair value hierarchy totaled \$9 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 November 30, 2013 and May 31, 2013, investments classified within Level 1 of the fair value hierarchy totaled \$26 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 November 30, 2013 and May 31, 2013, time deposits classified within Level 2 of the fair value hierarchy totaled \$800 million and \$700 million, respectively.

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 November 30, 2013 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 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 non-performing and restructured loans, are valued by using collateral valuations or by adjusting cash flows for credit risk and discounting those cash flows using the current rates at which similar loans would be made by us to borrowers for the same remaining maturities. See Note 11, Fair Value Measurement, for more details about how we calculate the fair value of certain non-performing 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 November 30, 2013 and May 31, 2013, totaled \$20,746 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 November 30, 2013 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 November 30, 2013 and May 31, 2013, short-term debt classified within the Level 1 of the fair value hierarchy is based on quoted prices in active markets and totaled \$2,633 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 November 30, 2013 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 \$1,625 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 November 30, 2013 and May 31, 2013, short-term debt classified within the Level 2 of the fair value hierarchy totaled \$1,639 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 the Level 3 of the fair value hierarchy includes our notes payable, members' subordinated certificates and members' capital securities due within one year and totaled \$584 million and \$789 million at November 30, 2013 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 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 November 30, 2013 and May 31, 2013, long-term debt classified within the Level 2 of the fair value hierarchy totaled \$8,187 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 all underwritten collateral trust bonds and medium-term notes; therefore, dealer quotes and recent market prices are both used in estimating fair value. There is essentially no secondary market for the medium-term notes issued to our members or in transactions that are not underwritten; therefore, fair value is estimated based on observable benchmark yields and spreads for similar instruments supplied by banks that underwrite our other debt transactions.

The long-term notes payable are issued in private placement transactions and there is no secondary trading of such debt. Long-term notes payable are classified within Level 3 of the fair value hierarchy. Long-term debt classified within the Level 3 of the fair value hierarchy totaled \$5,257 million and \$4,746 million at November 30, 2013 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 November 30, 2013 and May 31, 2013, guarantees classified within Level 3 of the fair value hierarchy totaled \$27 million and \$28 million, respectively.

Subordinated Deferrable Debt

Subordinated deferrable debt outstanding was issued in an underwritten public transaction. There is not 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 November 30, 2013 and May 31, 2013, subordinated deferrable debt classified within the Level 2 of the fair value hierarchy totaled \$376 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. Membership, loan and guarantee subordinated certificates are non-transferable other than among members with CFC's consent. There is no ready market from which

to obtain fair value quotes for membership, loan and guarantee subordinated certificates. These certificates are valued at par. There also is no ready market from which to obtain fair value quotes for member capital securities. Fair value for member capital securities is based on the discounted cash flows using the coupon interest rate on the last business day of the reporting period. Members' subordinated certificates are classified within Level 3 of the fair value hierarchy. At November 30, 2013 and May 31, 2013, members' subordinated certificates classified within Level 3 of the fair value hierarchy totaled \$1,755 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 November 30, 2013 and May 31, 2013, derivative asset instruments classified within Level 2 of the fair value hierarchy totaled \$292 million and \$258 million, respectively, and derivative liability instruments classified within Level 2 of the fair value hierarchy totaled \$398 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 six months ended November 30, 2013 and 2012 and condensed consolidated balance sheets at November 30, 2013 and 2012.

(dollar amounts in thousands)	For the six months ended November 30, 2013			
	CFC	Other	Elimination	Consolidated
Statement of operations:				
Interest income	\$ 472,831	\$ 25,345	\$ (17,851)	\$ 480,325
Interest expense	(332,200)	(18,581)	17,851	(332,930)
Net interest income	140,631	6,764	-	147,395
Provision for loan losses	(2,374)	-	-	(2,374)
Net interest income after provision for loan losses	138,257	6,764	-	145,021
Non-interest income:				
Fee and other income	8,187	694	400	9,281
Derivative gains	74,351	1,253	-	75,604
Results of operations from foreclosed assets	(7,318)	-	-	(7,318)
Total non-interest income	75,220	1,947	400	77,567
Non-interest expense:				
General and administrative expenses	(32,663)	(4,125)	(400)	(37,188)
Provision for guarantee liability	(42)	-	-	(42)
Other	(299)	1	-	(298)
Total non-interest expense	(33,004)	(4,124)	(400)	(37,528)
Income prior to income taxes	180,473	4,587	-	185,060
Income tax expense	-	(1,802)	-	(1,802)
Net income	\$ 180,473	\$ 2,785	\$ -	\$ 183,258

Assets:

Edgar Filing: NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORP /DC/ - Form 10-Q

Total loans outstanding	\$ 20,342,560	\$ 1,199,116	\$ (1,163,246)	\$ 20,378,430
Deferred origination costs	9,790	-	-	9,790
Less: Allowance for loan losses	(55,199)	-	-	(55,199)
Loans to members, net	20,297,151	1,199,116	(1,163,246)	20,333,021
Other assets	2,079,206	140,738	(121,601)	2,098,343
Total assets	\$ 22,376,357	\$ 1,339,854	\$ (1,284,847)	\$ 22,431,364

(dollar amounts in thousands)	For the six months ended November 30, 2012			
	CFC	Other	Elimination	Consolidated
Statement of operations:				
Interest income	\$ 473,682	\$ 28,333	\$ (20,300)	\$ 481,715
Interest expense	(350,034)	(21,163)	20,300	(350,897)
Net interest income	123,648	7,170	-	130,818
Provision for loan losses	(5,305)	-	-	(5,305)
Net interest income after provision for loan losses	118,343	7,170	-	125,513
Non-interest income:				
Fee and other income	22,533	686	(454)	22,765
Derivative losses	(26,436)	(1,922)	-	(28,358)
Results of operations from foreclosed assets	(5,674)	-	-	(5,674)
Total non-interest income	(9,577)	(1,236)	(454)	(11,267)
Non-interest expense:				
General and administrative expenses	(32,297)	(4,778)	454	(36,621)
Recovery of guarantee liability	101	-	-	101
Other	(4,547)	-	-	(4,547)
Total non-interest expense	(36,743)	(4,778)	454	(41,067)
Income prior to income taxes	72,023	1,156	-	73,179
Income tax expense	-	(452)	-	(452)
Net income	\$ 72,023	\$ 704	\$ -	\$ 72,727
Assets:				
Total loans outstanding	\$ 19,064,837	\$ 1,230,471	\$ (1,198,134)	\$ 19,097,174
Deferred origination costs	8,033	-	-	8,033
Less: Allowance for loan losses	(148,737)	-	-	(148,737)
Loans to members, net	18,924,133	1,230,471	(1,198,134)	18,956,470
Other assets	1,623,931	153,837	(123,844)	1,653,924
Total assets	\$ 20,548,064	\$ 1,384,308	\$ (1,321,978)	\$ 20,610,394

The following tables contain the segment presentation for the condensed consolidated statements of operations for the three months ended November 30, 2013 and 2012.

(dollar amounts in thousands)	For the three months ended November 30, 2013			
	CFC	Other	Elimination	Consolidated
Statement of operations:				
Interest income	\$ 235,505	\$ 12,582	\$ (8,833)	\$ 239,254

Edgar Filing: NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORP /DC/ - Form 10-Q

Interest expense	(164,980)	(9,198)	8,833	(165,345)
Net interest income	70,525	3,384	-	73,909
Provision for loan losses	(1,096)	-	-	(1,096)
Net interest income after provision for loan losses	69,429	3,384	-	72,813
Non-interest income:				
Fee and other income	4,163	342	620	5,125
Derivative losses	(29,232)	(1,548)	-	(30,780)
Results of operations from foreclosed assets	(3,269)	-	-	(3,269)
Total non-interest income	(28,338)	(1,206)	620	(28,924)
Non-interest expense:				
General and administrative expenses	(15,942)	(2,011)	(620)	(18,573)
Provision for guarantee liability	(73)	-	-	(73)
Other	(151)	1	-	(150)
Total non-interest expense	(16,166)	(2,010)	(620)	(18,796)
Income prior to income taxes	24,925	168	-	25,093
Income tax expense	-	(101)	-	(101)
Net income	\$ 24,925	\$ 67	\$ -	\$ 24,992

(dollar amounts in thousands)	For the three months ended November 30, 2012			
	CFC	Other	Elimination	Consolidated
Statement of operations:				
Interest income	\$ 237,711	\$ 13,946	\$ (10,027)	\$ 241,630
Interest expense	(173,870)	(10,458)	10,027	(174,301)
Net interest income	63,841	3,488	-	67,329
Recovery of loan losses	3,817	-	-	3,817
Net interest income after recovery of loan losses	67,658	3,488	-	71,146
Non-interest income:				
Fee and other income	17,741	292	(226)	17,807
Derivative losses	(3,391)	(375)	-	(3,766)
Results of operations from foreclosed assets	(909)	-	-	(909)
Total non-interest income	13,441	(83)	(226)	13,132
Non-interest expense:				
General and administrative expenses	(17,425)	(2,252)	226	(19,451)
Recovery of guarantee liability	92	-	-	92
Other	(4,384)	-	-	(4,384)
Total non-interest expense	(21,717)	(2,252)	226	(23,743)
Income prior to income taxes	59,382	1,153	-	60,535
Income tax expense	-	(454)	-	(454)
Net income	\$ 59,382	\$ 699	\$ -	\$ 60,081

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

The following discussion and analysis is designed to provide a better understanding of our consolidated financial condition and results of operations and as such should be read in conjunction with the condensed consolidated financial statements, including the notes thereto and the information contained elsewhere in this Form 10-Q, and Part I, Item 1A. Risk Factors in our Form 10-K for the year ended May 31, 2013.

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

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

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

Our primary objective as a member-owned cooperative lender is to provide cost-based financial products to our rural electric and telecommunications members while maintaining sound financial results required for investment-grade credit ratings on our debt instruments. Our objective is not to maximize net income; therefore, the rates we charge our member-borrowers reflect our adjusted interest expense plus a spread to cover our operating expenses, a provision for loan losses and earnings sufficient to achieve interest coverage to meet our financial objectives. Our goal is to earn an annual minimum adjusted TIER of 1.10 and to achieve and maintain an adjusted debt-to-equity ratio below 6.00-to-1.

Executive Summary

Lending Activity

At November 30, 2013, total loans outstanding were \$20,378 million, which represented an \$82 million or 0.4 percent increase during the six months ended November 30, 2013, primarily due to an increase of \$79 million in CFC distribution loans and an increase of \$87 million in CFC power supply loans partly offset by a decrease of \$77 million in NCSC and RTFC loans.

During the six months ended November 30, 2013, \$480 million of CFC long-term fixed-rate loans repriced. Of this total, \$420 million selected a new long-term fixed rate; \$32 million selected a long-term variable rate; \$11 million selected a new rate offered as part of our loan sales program and were sold by CFC with CFC continuing to service the loans sold; and \$17 million were repaid in full.

Funding Activity

At November 30, 2013, total debt outstanding was \$20,812 million, which represented a \$267 million or 1.3 percent increase during the six months ended November 30, 2013, primarily due to funding for the \$82 million increase in loans outstanding and the \$224 million increase in cash and time deposits. During the six months ended November 30, 2013, we funded the overall growth in our total assets and refinanced maturing debt with a mix of original issue short-term debt, collateral trust bonds and notes payable issued under the Guaranteed Underwriter Program.

Since May 31, 2013, long-term debt maturing in the next 12 months decreased by \$1,461 million, which we refinanced through the issuance of original issue short-term debt and other long-term debt funding. Specifically, original issue short-term debt increased by \$208 million as we continued to maintain a high utilization of our commercial paper and other original issue short-term funding to take advantage of the low interest rate environment. At November 30, 2013 and May 31, 2013, commercial paper, select notes, daily liquidity fund and bank bid notes outstanding represented 20 percent of total debt outstanding. Further, on July 18, 2013, we borrowed \$325 million as part of the Guaranteed Underwriter Program at a weighted average interest rate of 2.49 percent. In June 2013, we issued \$400 million of 2.35 percent collateral trust bonds due 2020 and in November 2013 we issued \$400 million of 3.40 percent collateral trust bonds due 2023.

Financial Results

For the six months ended November 30, 2013 and 2012, we reported net income of \$183 million and \$73 million, respectively, and TIER of 1.55 and 1.21, respectively. As previously mentioned, we use adjusted non-GAAP measures in our analysis to evaluate our performance and for debt covenant compliance. For the six months ended November 30, 2013 and 2012, our adjusted net income was \$71 million and \$72 million, respectively, and adjusted TIER was 1.19 for both periods.

The decrease to our adjusted net income for the six months ended November 30, 2013 as compared with the prior-year period was driven primarily by a \$13 million decrease in fee and other income partially offset by a \$10 million increase in adjusted net interest income. The decrease in fee income was due to a \$13 million prepayment fee received on a capital expenditures loan in September 2012. The increase in adjusted net interest income of \$10 million was primarily due to the refinancing of higher cost debt with lower cost debt and the continued higher utilization of our commercial paper issuance capacity.

At November 30, 2013, our debt-to-equity ratio decreased to 22.64-to-1 compared with 26.21-to-1 at May 31, 2013. As mentioned previously, we use adjusted non-GAAP measures in our own analysis to evaluate our performance and for covenant compliance. Our adjusted debt-to-equity ratio increased to 5.82-to-1 at November 30, 2013 compared with 5.76-to-1 at May 31, 2013 due to the increase in adjusted liabilities partially offset by the increase in adjusted equity.

Outlook for the Next 12 Months

We expect the amount of scheduled long-term loan repayments to slightly exceed new long-term loan advances over the next 12 months and we expect earnings from core lending operations to be fairly stable over the next 12 months.

During the six months ended November 30, 2013, the CFC Board of Directors authorized management to execute the call of our 7.5 percent member capital securities held by CFC members. As of November 30, 2013, notice was

provided to members for the early call of \$86 million of the 7.5 percent member capital securities. The call dates for the \$86 million will take place through February 2014. Over the next 12 months, we expect to provide notice to members for the early call of an additional \$301 million of 7.5 percent member capital securities with call dates through February 2015. The Board of Directors also authorized management to offer members the option to reinvest the proceeds from the early call of the 7.5 percent member capital securities, into a new series of 5 percent member capital securities.

We have \$4,258 million of short-term debt and \$2,209 million of long-term debt scheduled to mature over the next 12 months. We believe that we have sufficient liquidity from the combination of member loan repayments and our ability to issue debt in the capital markets, to our members and in private placements, to satisfy member loan advances and meet our need to fund long-term debt maturing over the next 12 months. At November 30, 2013, we had \$1,128 million in cash, investments and time deposits, up to \$924 million available under committed loan facilities from the Federal Financing Bank, \$3,343 million available under committed revolving lines of credit with a syndicate of banks and, subject to market conditions, up to \$2,371 million available under a revolving note purchase agreement with the Federal Agriculture Mortgage Corporation. 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. We also have the ability to issue collateral trust bonds and medium-term notes in the capital markets and medium-term notes to members. We believe we can continue to roll over the \$4,258 million of commercial paper, select notes, daily

liquidity fund and bank bid notes scheduled to mature over the next 12 months, as we expect to continue to maximize the utilization of these short-term funding options. We expect to be in compliance with the covenants under our revolving credit agreements; therefore, we could draw on these facilities to repay dealer or member commercial paper that cannot be rolled over in the event of market disruptions.

We expect to be able to maintain the adjusted debt-to-equity ratio below 6.00-to-1 over the next 12 months.

Results of Operations

The following table presents the results of operations for the three and six months ended November 30, 2013 and 2012.

(dollar amounts in thousands)	For the three months ended November 30,			For the six months ended November 30,		
	2013	2012	Change	2013	2012	Change
Interest income	\$ 239,254	\$ 241,630	\$ (2,376)	\$ 480,325	\$ 481,715	\$ (1,390)
Interest expense	(165,345)	(174,301)	8,956	(332,930)	(350,897)	17,967
Net interest income	73,909	67,329	6,580	147,395	130,818	16,577
(Provision for) recovery of loan losses	(1,096)	3,817	(4,913)	(2,374)	(5,305)	2,931
Net interest income after (provision for) recovery of loan losses	72,813	71,146	1,667	145,021	125,513	19,508
Non-interest income:						
Fee and other income	5,125	17,807	(12,682)	9,281	22,765	(13,484)
Derivative (losses) gains	(30,780)	(3,766)	(27,014)	75,604	(28,358)	103,962
Results of operations from foreclosed assets	(3,269)	(909)	(2,360)	(7,318)	(5,674)	(1,644)
Total non-interest income	(28,924)	13,132	(42,056)	77,567	(11,267)	88,834
Non-interest expense:						
Salaries and employee benefits	(9,018)	(10,148)	1,130	(19,346)	(20,553)	1,207
Other general and administrative expenses	(9,555)	(9,303)	(252)	(17,842)	(16,068)	(1,774)
(Provision for) recovery of guarantee liability	(73)	92	(165)	(42)	101	(143)
Other	(150)	(4,384)	4,234	(298)	(4,547)	4,249
Total non-interest expense	(18,796)	(23,743)	4,947	(37,528)	(41,067)	3,539
Income prior to income taxes	25,093	60,535	(35,442)	185,060	73,179	111,881
Income tax expense	(101)	(454)	353	(1,802)	(452)	(1,350)
Net income	24,992	60,081	(35,089)	183,258	72,727	110,531

Less: Net income attributable to noncontrolling interest	(67)	(699)	632	(2,785)	(704)	(2,081)
Net income attributable to CFC	\$ 24,925	\$ 59,382	\$ (34,457)	\$ 180,473	\$ 72,023	\$ 108,450
Adjusted net income	\$ 36,301	\$ 48,391	\$ (12,090)	\$ 71,498	\$ 71,766	\$ (268)
Adjusted interest expense	\$ (184,816)	\$ (189,757)	\$ 4,941	\$ (369,086)	\$ (380,216)	\$ 11,130

TIER	1.15	1.34	1.55	1.21
Adjusted TIER (1)	1.20	1.26	1.19	1.19

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

Interest Income

The following tables break out the average rate on loans and the change to interest income due to changes in average loan volume versus changes to interest rates summarized by loan type.

Average balances and interest rates – Assets

(dollar amounts in thousands)	For the three months ended November 30,					
	2013	2012	2013	2012	2013	2012
	Average volume		Interest income		Average yield	
Long-term fixed-rate loans	\$ 18,381,382	\$ 17,138,897	\$ 221,952	\$ 218,247	4.84%	5.11%
Long-term variable-rate loans	700,124	642,677	4,826	4,893	2.76	3.05
Line of credit loans	1,417,244	1,163,508	7,505	7,413	2.12	2.56
Restructured loans (2)	7,586	92,944	-	7,625	-	32.91
Non-performing loans	12,704	47,747	-	-	-	-
Total	20,519,040	19,085,773	234,283	238,178	4.58	5.01
Investments	949,864	356,532	1,817	1,576	0.77	1.77
Fee income (1)	-	-	3,154	1,876	-	-
Total	\$ 21,468,904	\$ 19,442,305	\$ 239,254	\$ 241,630	4.47	4.98

Average balances and interest rates – Assets

(dollar amounts in thousands)	For the six months ended November 30,					
	2013	2012	2013	2012	2013	2012
	Average volume		Interest income		Average yield	
Long-term fixed-rate loans	\$ 18,364,696	\$ 16,967,005	\$ 446,535	\$ 436,187	4.85%	5.13%
Long-term variable-rate loans	699,276	692,218	9,654	10,918	2.75	3.15
Line of credit loans	1,218,411	1,156,766	15,077	15,105	2.47	2.60
Restructured loans (2)	14,036	274,565	136	13,087	1.93	9.51
Non-performing loans	14,084	48,105	-	-	-	-
Total	20,310,503	19,138,659	471,402	475,297	4.63	4.95
Investments	892,787	391,837	3,753	2,514	0.84	1.28
Fee income (1)	-	-	5,170	3,904	-	-
Total	\$ 21,203,290	\$ 19,530,496	\$ 480,325	\$ 481,715	4.52	4.92

(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.

(2) On September 13, 2012, we received a prepayment from one of our borrowers, with \$414 million applied to the restructured loan balance, as well as applicable interest due on the restructured loan.

Analysis of changes in interest income

For the three months ended
November 30, 2013 vs. 2012

For the six months ended
November 30, 2013 vs. 2012

(dollar amounts in thousands)	Change due to (3)			Change due to (3)		
	Average volume (1)	Average rate (2)	Net change	Average volume (1)	Average rate (2)	Net change
Increase (decrease) in interest income:						
Long-term fixed-rate loans	\$ 15,822	\$ (12,117)	\$ 3,705	\$ 35,932	\$ (25,584)	\$ 10,348
Long-term variable-rate loans	437	(504)	(67)	111	(1,375)	(1,264)
Line of credit loans	1,617	(1,525)	92	805	(833)	(28)
Restructured loans	(7,003)	(622)	(7,625)	(12,418)	(533)	(12,951)
Total interest income on loans	10,873	(14,768)	(3,895)	24,430	(28,325)	(3,895)
Investments	2,623	(2,382)	241	3,214	(1,975)	1,239
Fee income	-	1,278	1,278	-	1,266	1,266
Total interest income	\$ 13,496	\$ (15,872)	\$ (2,376)	\$ 27,644	\$ (29,034)	\$ (1,390)

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

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

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

During the three months ended November 30, 2013, interest income decreased by 1 percent compared with the prior-year period, primary due to the 43 basis-point decrease in the average rate on loans, partly offset by the increase in average loan balances and the \$2 million increase in the interest income earned on our time deposits and fee income. During the six months ended November 30, 2013, interest income decreased by 0.3 percent compared with the prior-year period, primary due to the 32 basis-point decrease in the average rate on loans, partly offset by the increase in average loan balances and the

\$3 million increase in the interest income earned on our time deposits and fee income. The decrease in the total interest income earned on loans for the three and six months ended November 30, 2013 compared to the prior-year periods was driven primarily by the decrease of \$8 million and \$13 million, respectively, in interest income earned on restructured loans. The decrease in income on restructured loans is due to the pay-off of a \$414 million restructured loan in September 2012.

The increase in interest income earned on long-term fixed-rate loans during the three and six months ended November 30, 2013 compared to the prior-year periods was primarily due to the \$1,242 million and \$1,398 million increase in average fixed-rate loan balances, respectively, partly offset by a 27 basis-point and 28 basis-point decrease in the weighted average rate earned on our long-term fixed-rate loans, respectively. The increase in average fixed-rate loan balances was primarily due to a large amount of advances to CFC and NCSC borrowers during the fourth quarter of fiscal 2013 to refinance debt from other lenders, to fund capital improvements and for new loan advances. The decrease in average yield on fixed-rate loans was due to activity in the capital markets and the repricing of loans. As a cost-based lender, our fixed interest rates reflect our cost of borrowing in the capital markets marked up to cover our cost of operations. As benchmark treasury rates and spreads tightened over the past few years, there was a continued reduction in the rates we had to pay for funding in the capital markets and we lowered the long-term fixed rates we offered on our new loans. Although the average long-term fixed interest rates we offered on electric loans started to increase during the three and six months ended November 30, 2013, the residual impact of lower rates offered over the past few years continued to result in a decrease in the average yield earned when comparing the three months and six months ended November 30, 2013 to the prior-year periods. In addition, during the six months ended November 30, 2013, \$480 million of long-term fixed rate loans repriced and the borrowers of \$420 million of these loans selected a new long-term fixed rate, which on average was lower than the rate prior to the repricing.

Our non-performing and restructured loans on non-accrual status affect interest income for both the current and prior-year period. The effect of non-accrual loans on interest income is included in the rate variance in the table on page 35. Foregone interest income was as follows as a result of holding loans on non-accrual status:

(dollar amounts in thousands)	For the three months ended November 30,		For the six months ended November 30,	
	2013	2012	2013	2012
Electric	\$ 159	\$ 267	\$ 317	\$ 565
Telecommunications	105	106	248	215
Total	\$ 264	\$ 373	\$ 565	\$ 780

Interest Expense

The following tables break out the average cost of debt and the change to interest expense due to changes in average debt volume versus changes to interest rates summarized by debt type. We do not fund each individual loan with specific debt. Rather, we attempt to minimize costs and maximize efficiency by funding large aggregated amounts of loans. The following tables also break out the change to derivative cash settlements due to changes in the average notional amount of our derivative portfolio versus changes to the net difference between the average rate paid and the average rate received. Additionally, the tables present adjusted interest expense, which includes all derivative cash settlements in interest expense. See Non-GAAP Financial Measures for further explanation of the adjustment we make in our financial analysis to include all derivative cash settlements in interest expense.

Average balances and interest rates – Liabilities

For the three months ended November 30,

Edgar Filing: NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORP /DC/ - Form 10-Q

	2013	2012	2013	2012	2013	2012
(dollar amounts in thousands)						
	Average volume		Interest expense		Average cost	
Short-term debt (1) (2)	\$ 4,415,278	\$ 3,394,771	\$ (1,607)	\$ (1,697)	(0.15)%	(0.20)%
Medium-term notes (1)	2,720,722	2,623,679	(20,980)	(24,833)	(3.09)	(3.80)
Collateral trust bonds (1)	5,795,684	6,222,897	(74,858)	(82,271)	(5.18)	(5.30)
Subordinated deferrable debt (1)	395,659	181,058	(4,750)	(2,807)	(4.82)	(6.22)
Subordinated certificates (1)	1,751,394	1,728,603	(20,494)	(20,528)	(4.69)	(4.76)
Long-term notes payable (1)	5,530,105	4,881,191	(38,759)	(37,915)	(2.81)	(3.12)
Total	20,608,842	19,032,199	(161,448)	(170,051)	(3.14)	(3.58)
Debt issuance costs (3)	-	-	(1,782)	(1,905)	-	-
Fee expense (4)	-	-	(2,115)	(2,345)	-	-
Total	\$ 20,608,842	\$ 19,032,199	\$ (165,345)	\$ (174,301)	(3.22)	(3.67)
Derivative cash settlements (5)	\$ 8,297,021	\$ 9,252,825	\$ (19,471)	\$ (15,456)	%	
Adjusted interest expense (6)	20,608,842	19,032,199	(184,816)	(189,757)	(0.94)	(0.67)%

Average balances and interest rates – Liabilities

	For the six months ended November 30,					
	2013	2012	2013	2012	2013	2012
(dollar amounts in thousands)						
	Average volume		Interest expense		Average cost	
Short-term debt (1) (2)	\$ 4,196,329	\$ 3,357,570	\$ (3,039)	\$ (3,316)	(0.14)%	(0.20)%
Medium-term notes (1)	2,860,230	2,573,378	(42,551)	(52,716)	(2.97)	(4.09)
Collateral trust bonds (1)	5,875,475	6,276,068	(151,656)	(163,710)	(5.15)	(5.20)
Subordinated deferrable debt (1)	395,711	181,001	(9,500)	(5,613)	(4.79)	(6.19)
Subordinated certificates (1)	1,730,178	1,714,449	(41,120)	(40,882)	(4.74)	(4.76)
Long-term notes payable (1)	5,449,920	4,780,003	(76,698)	(76,311)	(2.81)	(3.18)
Total	20,507,843	18,882,469	(324,564)	(342,548)	(3.16)	(3.62)
Debt issuance costs (3)	-	-	(3,647)	(3,842)	-	-
Fee expense (4)	-	-	(4,719)	(4,507)	-	-
Total	\$ 20,507,843	\$ 18,882,469	\$ (332,930)	\$ (350,897)	(3.24)	(3.71)

Derivative cash settlements (5)	\$ 8,392,169	\$ 9,306,967	\$ (36,156)	\$ (29,319)	(0.86)%	(0.63)%
Adjusted interest expense (6)	20,507,843	18,882,469	(369,086)	(380,216)	(3.59)	(4.02)

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

(2) Average volume and interest expense includes commercial paper, daily liquidity fund, bank bid notes and select notes.

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

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

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

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

Analysis of changes in interest expense

	For the three months ended November 30, 2013 vs. 2012			For the six months ended November 30, 2013 vs. 2012		
	Change due to (3)			Change due to (3)		
(dollar amounts in thousands)	Average volume (1)	Average rate (2)	Net change	Average volume (1)	Average rate (2)	Net change
(Increase) decrease in interest expense:						
Short-term debt	\$ (510)	\$ 600	\$ 90	\$ (829)	\$ 1,106	\$ 277

Medium-term notes	(919)	4,772	3,853	(5,876)	16,041	10,165
Collateral trust bonds	5,648	1,765	7,413	10,449	1,605	12,054
Subordinated deferrable debt	(3,327)	1,384	(1,943)	(6,658)	2,771	(3,887)
Subordinated certificates	(271)	305	34	(375)	137	(238)
Long-term notes payable	(5,040)	4,196	(844)	(10,695)	10,308	(387)
Total interest expense on debt	(4,419)	13,022	8,603	(13,984)	31,968	17,984
Debt issuance costs	-	123	123	-	195	195
Fee expense	-	230	230	-	(212)	(212)
Total interest expense	\$ (4,419)	\$ 13,375	\$ 8,956	\$ (13,984)	\$ 31,951	\$ 17,967
Derivative cash settlements (4)	\$ 1,597	\$ (5,612)	\$ (4,015)	\$ 2,882	\$ (9,719)	\$ (6,837)
Adjusted interest expense (5)	(2,822)	7,763	4,941	(11,102)	22,232	11,130

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

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

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

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

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

During the three and six months ended November 30, 2013, the average balance of debt outstanding increased by 8 percent and 9 percent, respectively, compared to the prior-year periods in order to fund the overall growth in our balance sheet. Despite the increase in average debt outstanding, total interest expense decreased by 5 percent compared with the prior-year periods. The lower interest rates and tighter credit spreads available in the capital markets allowed us to refinance maturing debt at a lower cost. Specifically, the decrease in interest expense for the three and six months ended November 30, 2013 is

due to the 45 basis-point and 47 basis-point reduction in the total weighted average cost of debt, respectively. The lower average interest rate on debt is primarily due to the refinancing of \$340 million of 8 percent medium-term notes in the second quarter of fiscal year 2013 and an overall decrease in the average volume of collateral trust bonds outstanding partially offset by an increase in the average volume of subordinated deferrable debt. We funded the refinancing of higher cost medium-term notes as well as the overall growth in our balance sheet with a mix of lower-cost short-term debt, medium-term notes, and notes payable issued under the Guaranteed Underwriter Program and our agreement with the Federal Agricultural Mortgage Corporation. Short-term debt is our lowest cost of funding, with an average cost of 15 basis points and 14 basis points for the three and six months ended November 30, 2013, respectively. Our utilization of short-term debt increased from 18 percent to 21 percent and 20 percent of average total debt during the three and six months ended November 30, 2013, respectively, compared with the prior-year periods, while the weighted average rate paid for these instruments during the same periods decreased slightly.

Adjusted interest expense, which includes all derivative cash settlements, was \$185 million and \$369 million for the three and six months ended November 30, 2013, respectively, compared with \$190 million and \$380 million for three and six months ended November 30, 2012, respectively. The decrease in adjusted interest expense during the three and six months ended November 30, 2013 was due to the lower interest expense noted above, partially offset by an increase in derivative cash settlements expense during the three and six months ended November 30, 2013. See Non-GAAP Financial Measures for further explanation of the adjustment we make in our financial analysis to include all derivative cash settlements in interest expense.

Net Interest Income

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

Average interest rates – Assets and Liabilities

(dollar amounts in thousands)	For the three months ended November 30,			
	2013	2012	2013	2012
	Interest income (expense)		Average yield (cost)	
Total interest income	\$ 239,254	\$ 241,630	4.47%	4.98%
Total interest expense	(165,345)	(174,301)	(3.22)	(3.67)
Net interest income/Net yield	\$ 73,909	\$ 67,329	1.25%	1.31%

Average interest rates –