NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORP /DC/
Form 10-Q
October 14, 2009

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended August 31, 2009

OR

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

Commission File Number 1-7102

NATIONAL RURAL UTILITIES COOPERATIVE
FINANCE CORPORATION

(Exact name of registrant as specified in its charter)

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

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark 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 is a tax-exempt cooperative and consequently is unable to issue any equity capital stock.

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(in thousands)

A S S E T S

	August 31, 2009	May 31, 2009
Cash and cash equivalents	$ 526,526	$ 504,999
Restricted cash	3,273	8,207
Investments in preferred stock	72,000	47,000
Loans to members	20,131,092	20,192,309
Less: Allowance for loan losses	(606,839)	(622,960)
Loans to members, net	19,524,253	19,569,349
Accrued interest and other receivables	236,051	260,428
Fixed assets, net	44,818	43,162
Debt service reserve funds	46,662	46,662
Bond issuance costs, net	48,880	50,414
Foreclosed assets, net	47,558	48,721
Derivative assets	364,200	381,356
Other assets	22,351	22,407
	$ 20,936,572	$20,982,705

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(in thousands)

L I A B I L I T I E S A N D E Q U I T Y

	August 31, 2009	May 31, 2009
Short-term debt	$ 4,457,701	$ 4,867,864
Accrued interest payable	313,087	249,601
Long-term debt	12,939,760	12,720,055
Patronage capital retirement payable	41,400	-
Deferred income	20,779	18,962
Guarantee liability	26,536	29,672
Other liabilities	47,560	32,955
Derivative liabilities	486,847	493,002
Subordinated deferrable debt	311,440	311,440
Members' subordinated certificates:		
Membership subordinated certificates	642,925	642,960
Loan and guarantee subordinated certificates	817,939	818,999
Member capital securities	337,045	278,095
Total members' subordinated certificates	1,797,909	1,740,054
Commitments and contingencies		
National Rural equity:		
Retained equity	475,259	500,823
Accumulated other comprehensive income	7,959	8,115
Total National Rural equity	483,218	508,938
Noncontrolling interest	10,335	10,162
Total equity	493,553	519,100
	$ 20,936,572	$ 20,982,705

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)
(in thousands)

For the Three Months Ended August 31, 2009 and 2008

	Three months ended August 31, 2009	Three months ended August 31, 2008
Interest income	$ 269,457	$ 263,117
Interest expense	(242,629)	(220,149)
Net interest income	26,828	42,968
Recovery of (provision for) loan losses	16,171	(10,681)
Net interest income after recovery of (provision for) loan losses	42,999	32,287
Non-interest income:		
Fee and other income	3,734	3,582
Derivative cash settlements	(3,494)	431
Results of operations from foreclosed assets	587	1,246
Total non-interest income	827	5,259
Non-interest (expense)/income:		
Salaries and employee benefits	(9,918)	(9,851)
Other general and administrative expenses	(7,108)	(4,742)
Recovery of guarantee liability	2,395	705
Derivative forward value	(10,834)	(11,028)
Market adjustment of foreclosed assets	(1,750)	-
Other	(146)	(160)
Total non-interest expense	(27,361)	(25,076)
Income prior to income taxes	16,465	12,470
Income tax (expense) benefit	(32)	760

Net income	16,433	13,230
Less: Net (income) loss attributable to the noncontrolling interest	(191)	1,241
Net income attributable to National Rural	$ 16,242	$ 14,471

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(UNAUDITED)
(in thousands)

For the Three Months Ended August 31, 2009 and 2008

	Total	Noncontrolling Interest	National Rural Total Equity	Accumulated Other Comprehensive Income (Loss)	National Rural Retained Equity	Unallocated Net Income	Members' Capital Reserve	Patronage Capital Allocated	Membership Fees and Education Fund
Three months ended August 31, 2009:									
Balance as of May 31, 2009	$519,100	$10,162	$ 508,938	$ 8,115	$500,823	$ (109,691)	$187,098	$ 420,834	$2,582
Patronage capital retirement	(41,400)	-	(41,400)	-	(41,400)	-	-	(41,400)	-
Net income	16,433	191	16,242	-	16,242	16,242	-	-	-
Other comprehensive loss	(162)	(6)	(156)	(156)	-	-	-	-	-
Other	(418)	(12)	(406)	-	(406)	-	-	-	(406)
Balance as of August 31, 2009	$493,553	$10,335	$ 483,218	$ 7,959	$475,259	$ (93,449)	$187,098	$ 379,434	$2,176
Three months ended August 31, 2008:									
Balance as of May 31, 2008	$680,212	$14,247	$ 665,965	$ 8,827	$657,138	$ 44,003	$187,409	$423,249	$2,477
Patronage capital retirement	(85,238)	-	(85,238)	-	(85,238)	-	-	(85,238)	-
Net income	13,230	(1,241)	14,471	-	14,471	14,471	-	-	-
Other comprehensive loss	(199)	(5)	(194)	(194)	-	-	-	-	-
Other	(355)	-	(355)	-	(355)	-	-	-	(355)
Balance as of August 31, 2008	$607,650	$13,001	$594,649	$ 8,633	$586,016	$58,474	$187,409	$338,011	$2,122

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

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

For the Three Months Ended August 31, 2009 and 2008

	2009	2008
CASH FLOWS PROVIDED BY OPERATING ACTIVITIES:		
Net income	$ 16,433	$ 13,230
Add (deduct):		
Amortization of deferred income	(1,463)	(1,633)
Amortization of bond issuance costs and deferred charges	5,419	2,384
Depreciation	596	610
Recovery of (provision for) loan losses	(16,171)	10,681
Recovery of guarantee liability	(2,395)	(705)
Results of operations from foreclosed assets	(587)	(1,246)
Market adjustment on foreclosed assets	1,750	-
Derivative forward value	10,834	11,028
Restricted interest earned on restricted cash	-	(64)
Changes in operating assets and liabilities:		
Accrued interest and other receivables	20,380	(23,540)
Accrued interest payable	63,486	64,901
Other	14,065	10,019
Net cash provided by operating activities	112,347	85,665
CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES:		
Advances made on loans	(1,666,956)	(2,596,707)
Principal collected on loans	1,699,490	2,256,780
Net investment in fixed assets	(2,252)	(1,000)
Net proceeds from sale of loans	28,626	-
Investments in preferred stock	(25,000)	-
Change in restricted cash	4,935	5,912
Net cash provided by (used in) investing activities	38,843	(335,015)
CASH FLOWS (USED IN) PROVIDED BY FINANCING ACTIVITIES:		
Proceeds from issuances of short-term debt, net	687,624	723,544
Proceeds from issuance of long-term debt, net	789,482	1,450,611

Payments for retirement of long-term debt	(1,669,172)	(595,093)
Proceeds from issuance of members' subordinated certificates	72,795	29,642
Payments for retirement of members' subordinated certificates	(10,392)	(7,768)
Net cash (used in) provided by financing activities	(129,663)	1,600,936
NET INCREASE IN CASH AND CASH EQUIVALENTS	21,527	1,351,586
BEGINNING CASH AND CASH EQUIVALENTS	504,999	177,809
ENDING CASH AND CASH EQUIVALENTS	$ 526,526	$ 1,529,395

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

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

For the Three Months Ended August 31, 2009 and 2008

	2009	2008
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest	$ 173,725	$ 153,025
Non-cash financing and investing activities:		
Subordinated certificates applied against loan balances	$ -	$ 675
Patronage capital retirement payable	41,400	85,223
Patronage capital applied against loan balances	-	15
Net decrease in debt service reserve funds/debt service reserve certificates	(1,113)	(7,218)

See accompanying notes.

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NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

(1) General Information and Accounting Policies

(a) General Information

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

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

National Cooperative Services Corporation ("NCSC") was incorporated in 1981 in the District of Columbia as a private cooperative association. NCSC’s principal purpose is to provide financing to the for-profit or non-profit entities that are owned, operated or controlled by or provide substantial benefit to, members of National Rural. NCSC is a member-owned finance cooperative, therefore its objective is not to maximize its net income, but to offer its members low cost financial products and services consistent with sound financial management. NCSC's membership consists of National Rural and distribution systems that are members of National Rural or are eligible for such membership. NCSC's results of operations and financial condition are consolidated with those of National Rural in the accompanying financial statements. NCSC is headquartered with National Rural in Herndon, Virginia. NCSC is a taxable corporation.

Our consolidated membership totaling 1,522 members at August 31, 2009 is made up of:

- 829 distribution systems and 68 generation and transmission ("power supply") systems, totaling 897 utility members, the majority of which are consumer-owned electric cooperatives;
- 498 telecommunications members;
- 66 service members; and
- 61 associates.

Our members are located in 49 states, the District of Columbia and two U.S. territories. Memberships between National Rural, RTFC and NCSC have been eliminated in consolidation. All references to members within this document include members and associates.

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

These interim unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended May 31, 2009.

(b) Principles of Consolidation

The accompanying financial statements include the consolidated accounts of National Rural, RTFC and NCSC and certain entities created and controlled by National Rural to hold foreclosed assets and accommodate loan securitization transactions, after elimination of intercompany accounts and transactions. We are required to consolidate the financial results of RTFC and NCSC because we are the primary beneficiary of variable interests in RTFC and NCSC due to our exposure to absorbing the majority of expected losses.

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

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

RTFC and NCSC creditors have no recourse against National Rural in the event of a default by RTFC and NCSC, unless there is a guarantee agreement under which National Rural has guaranteed NCSC or RTFC debt obligations to a third party. At August 31, 2009, National Rural had guaranteed $292 million of NCSC debt, derivative instruments and guarantees with third parties. The maturities for NCSC obligations guaranteed by National Rural run through 2031. At August 31, 2009, National Rural's maximum potential exposure totaled $308 million for guarantees of NCSC debt, derivatives and guarantees with third parties. Guarantees related to NCSC debt and derivative instruments are not included in Note 11, Guarantees at August 31, 2009 as the debt and derivatives are reported on the consolidated balance sheet. At August 31, 2009, National Rural had $0.5 million of guarantees of RTFC debt to third party creditors. All National Rural loans to RTFC and NCSC are secured by all assets and revenues of RTFC and NCSC. At August 31, 2009, RTFC had total assets of $1,915 million including loans outstanding to members of $1,736 million and NCSC had total assets of $420 million including loans outstanding of $404 million. At August 31, 2009, National Rural had committed to lend RTFC up to $4 billion of which $1,725 million was outstanding. At June 1, 2009, National Rural increased the commitment to NCSC from $1 billion to $1.5 billion. At August 31, 2009, National Rural had committed to provide up to $1.5 billion of credit to NCSC of which $459 million was outstanding, representing $167 million of outstanding loans and $292 million of credit enhancements.

National Rural has established limited liability corporations and partnerships to hold foreclosed assets and facilitate loan securitization transactions. National Rural owns and controls all of these entities and therefore consolidates their financial results. National Rural presents the companies formed to hold foreclosed assets in one line on the consolidated balance sheets and the consolidated statements of operations. A full consolidation is presented for the entity formed for loan securitization transactions.

Unless stated otherwise, references to “we,” “our,” or “us” represent the consolidation of National Rural, RTFC, NCSC and certain entities created and controlled by National Rural to hold foreclosed assets and to accommodate loan securitization transactions.

Based on the accounting guidance governing consolidations, affiliate equity controlled by RTFC and NCSC is classified as noncontrolling interest on the consolidated balance sheet and the subsidiary earnings controlled by RTFC and NCSC is net income attributable to the noncontrolling interest on the consolidated statement of operations.

(c) Interest Income

The following table presents the components of interest income:

	For the three months ended August 31,	
(dollar amounts in thousands)	2009	2008
Interest on long-term fixed-rate loans (1)	$ 223,526	$ 224,402
Interest on long-term variable-rate loans (1)	26,565	15,180
Interest on short-term loans (1)	16,035	19,504
Interest on investments (2)	1,657	2,181
Fee income	1,674	1,850
Total interest income	$ 269,457	$ 263,117

(1) Represents interest income on loans to members.
(2) Represents interest income on the investment of cash and trading securities.

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Deferred income on the consolidated balance sheets is comprised primarily of deferred conversion fees totaling $15 million and $16 million at August 31, 2009 and May 31, 2009, respectively.

(d) Interest Expense

The following table presents the components of interest expense:

	For the three months ended August 31,	
(dollar amounts in thousands)	2009	2008
Interest expense (1):		
Commercial paper and bid notes	$ 3,222	$ 16,438
Medium-term notes	84,595	80,458
Collateral trust bonds	78,593	62,920
Subordinated deferrable debt	4,916	4,916
Subordinated certificates	19,020	12,417
Long-term private debt	45,986	39,439
Debt issuance costs (2)	2,980	2,135
Fee expense (3)	3,317	1,426
Total interest expense	$ 242,629	$ 220,149

(1) Represents interest expense and the amortization of discounts on debt.
(2) Includes amortization of all deferred charges related to the issuance of debt, principally underwriter'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.
(3) 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.

We do not include indirect costs, if any, related to funding activities in interest expense.

(e) Comprehensive Income

Comprehensive income includes our net income, as well as other comprehensive income related to derivatives. Comprehensive income is calculated as follows:

	For the three months ended August 31,	
(dollar amounts in thousands)	2009	2008
Net income	$ 16,433	$ 13,230
Other comprehensive income:		
Less: Realized gains on derivatives	(162)	(199)
Comprehensive income	16,271	13,031
Less: Comprehensive (income) loss attributable to the noncontrolling interest	(185)	1,246
Comprehensive income attributable to National Rural	$ 16,086	$ 14,277

Due to our adoption of new accounting guidance related to noncontrolling interest on June 1, 2009, our consolidated comprehensive income for the three months ended August 31, 2008 was adjusted to include comprehensive income attributable to our noncontrolling interest.

(f) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States ("GAAP") requires management to make estimates and assumptions that affect the assets, liabilities, revenues and expenses reported in the financial statements, as well as amounts included in the notes thereto, including discussion and disclosure of contingent liabilities. 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.

(g) Subsequent Events

We evaluated all subsequent events that occurred after the balance sheet date and through the date our unaudited consolidated financial statements were issued on October 14, 2009.

(h) Reclassifications

Reclassifications of prior period amounts have been made to conform to the current reporting format for the following two items. Fees and other income totaling $3 million for the quarter ended August 31, 2008 have been reclassified from interest income to the fee and other income line of non-interest income on the consolidated statements of operations to conform with the August 31, 2009 presentation. Other expense totaling $0.2 million for the quarter ended August 31, 2008 has been reclassified from interest expense to the other expense line item in non-interest expense on the consolidated statements of operations to conform with the August 31, 2009 presentation.

Due to the retrospective presentation and disclosure requirements of new accounting guidance for noncontrolling interests, we reflected the changes in presentation and disclosure of noncontrolling interest in our consolidated financial statements and footnotes for all periods presented in this Form 10-Q.

(i) New Accounting Pronouncements

In August 2009, the FASB issued Accounting Standards Update ("ASU") 2009-05 to update guidance on measuring the fair value of liabilities. This ASU provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the following techniques: 1) a valuation technique that uses a quoted price of an identical liability when traded as an asset or quoted prices for similar liabilities or similar liabilities when traded as assets and/or 2) another valuation technique including one of the following: a) a technique that is based on the amount at the measurement date that the reporting entity would pay to transfer an identical liability or b) a technique based on the amount a reporting entity would receive to enter into an identical liability. ASU 2009-05 also clarifies that both a quoted price in an active market for an identical liability at the measurement date and a quoted price for the identical liability when traded as an asset in an active market when no adjustments to the quoted price of the asset are required are Level 1 fair value measurements. The ASU is effective for financial statements issued for interim and annual periods beginning after August 28, 2009. The adoption of ASU 2009-05 is not expected to have a material impact on our consolidated financial statements.

(2) Loans and Commitments

Loans to members bear interest at rates determined from time to time by us after considering our interest expense, operating expenses, provision for loan losses and the maintenance of reasonable earnings levels. In compliance with our cooperative charter, our policy is to set interest rates at the lowest level we consider to be consistent with sound financial management.

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

(dollar amounts in thousands)	August 31, 2009 Loans Outstanding	August 31, 2009 Unadvanced Commitments (1)	May 31, 2009 Loans Outstanding	May 31, 2009 Unadvanced Commitments (1)
Total by loan type (2) (3):				
Long-term fixed-rate loans (4)	$ 15,246,074	$ -	$ 14,602,365	$ -
Long-term variable-rate loans (4)	2,676,702	5,744,267	3,243,716	5,609,977
Loans guaranteed by RUS	242,966	-	243,997	-
Short-term loans	1,960,743	8,066,747	2,098,129	7,941,146
Total loans outstanding	20,126,485	13,811,014	20,188,207	13,551,123
Deferred origination fees	4,607	-	4,102	-
	(606,839)	-	(622,960)	-

Less: Allowance for loan losses								
Net loans outstanding	$	19,524,253	$	13,811,014	$	19,569,349	$	13,551,123
Total by segment (2):								
National Rural:								
Distribution	$	13,637,987	$	9,349,777	$	13,730,511	$	9,472,849
Power supply		4,256,807		3,594,673		4,268,244		3,178,471
Statewide and associate		91,906		135,363		92,578		152,701
National Rural total		17,986,700		13,079,813		18,091,333		12,804,021
RTFC		1,735,709		450,561		1,680,154		457,022
NCSC		404,076		280,640		416,720		290,080
Total loans outstanding	$	20,126,485	$	13,811,014	$	20,188,207	$	13,551,123

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

Non-Performing and Restructured Loans

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

	August 31, 2009		May 31, 2009	
(dollar amounts in thousands)	Loans Outstanding	Unadvanced Commitments (1)	Loans Outstanding	Unadvanced Commitments (1)
Non-performing and restructured loans:				
Non-performing loans (2):				
RTFC:				
Long-term fixed-rate loans	$ 8,960	$ -	$ 8,960	$ -
Long-term variable-rate loans	457,504	-	457,504	-
Short-term loans	57,297	-	57,294	-
Total non-performing loans	$ 523,761	$ -	$ 523,758	$ -
Restructured loans (2):				
National Rural:				
Long-term fixed-rate loans (3)	$ 41,817	$ -	$ 41,907	$ -
Long-term variable-rate loans (3)	483,720	186,673	490,827	186,673
Short-term loans	-	12,500	-	12,500
National Rural total restructured loans	525,537	199,173	532,734	199,173
RTFC:				
Long-term fixed-rate loans	4,672	-	4,853	-
Total restructured loans	$ 530,209	$ 199,173	$ 537,587	$ 199,173

(1) Unadvanced loan commitments include loans for which loan contracts have been approved and executed, but funds have not been advanced. Before advancing funds, additional information may be required to assure that all conditions for the advance of funds have been fully met and there has been no material change in the member's condition as represented in the supporting documents. Since commitments may expire without being fully drawn upon and a significant amount of the commitments are for standby liquidity purposes, the total unadvanced loan commitments do not necessarily represent our future cash requirements. Collateral and security requirements for advances on commitments are identical to those required at the time of the initial loan approval.

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

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

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.

Activity in the loan loss allowance account is summarized below:

(dollar amounts in thousands)	For the three months ended and as of August 31, 2009	2008	For the year ended and as of May 31 ,2009
Balance at beginning of period	$ 622,960	$ 514,906	$ 514,906
(Recovery of) provision for loan losses	(16,171)	10,681	113,699
Charge-offs	(23)	(3,078)	(5,988)
Recoveries	73	88	343
Balance at end of period	$ 606,839	$ 522,597	$ 622,960

Loan Security

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

The following tables summarize our secured and unsecured loans outstanding by loan type and by segment:

(dollar amounts in thousands)	August 31, 2009				May 31, 2009			
Total by loan type:	Secured	%	Unsecured	%	Secured	%	Unsecured	%
Long-term fixed-rate loans	$ 14,634,667	96%	$ 611,407	4 %	$14,044,469	96%	$ 557,896	4%
Long-term variable-rate loans	2,298,042	86	378,660	14	2,835,451	87	408,265	13
Loans guaranteed by RUS	242,966	100	-	-	243,997	100	-	-
Short-term loans	235,169	12	1,725,574	88	233,179	11	1,864,950	89
Total loans	$17,410,844	87	$ 2,715,641	13	$17,357,096	86	$ 2,831,111	14
Total by segment:								
National Rural	$15,564,515	87%	$ 2,422,185	13%	$15,562,761	86%	$ 2,528,572	14%
RTFC	1,502,647	87	233,062	13	1,443,395	86	236,759	14
NCSC	343,682	85	60,394	15	350,940	84	65,780	16
Total loans	$17,410,844	87	$ 2,715,641	13	$17,357,096	86	$ 2,831,111	14

Pledging of Loans and Loans on Deposit

The following table summarizes our collateral pledged to secure our collateral trust bonds and notes payable to the Federal Agricultural Mortgage Corporation ("Farmer Mac") (see Note 5, Long-Term Debt) and the amount of the corresponding debt outstanding:

(dollar amounts in thousands)	August 31, 2009	May 31, 2009
Collateral trust bonds:		
2007 indenture		
Distribution system mortgage notes	$ 4,136,428	$ 4,176,760
Collateral trust bonds outstanding	3,000,000	3,000,000
1994 indenture		
Distribution system mortgage notes	$ 2,261,597	$ 2,308,713
RUS guaranteed loans qualifying as permitted investments	210,306	211,337
Total pledged collateral	$ 2,471,903	$ 2,520,050
Collateral trust bonds outstanding	2,190,000	2,190,000
1972 indenture		
Cash	$ 2,032	$ 2,032
Collateral trust bonds outstanding	1,736	1,736
Farmer Mac:		
Utility system notes	$ 2,231,050	$ 1,488,929
Farmer Mac notes payable	1,825,000	1,200,000

The following table shows the collateral on deposit for the notes payable to the Federal Financing Bank ("FFB") of the United States Treasury as part of the Rural Economic Development Loan and Grant ("REDLG") program (see Note 5, Long-Term Debt) and the amount of the corresponding debt outstanding:

(dollar amounts in thousands)	August 31, 2009	May 31, 2009
Utility system mortgage notes on deposit	$ 3,783,697	$ 3,770,983
REDLG notes payable	3,000,000	3,000,000

The $3 billion of notes payable to the FFB at August 31, 2009 and May 31, 2009 contain a rating trigger related to our senior secured credit ratings from Standard & Poor's Corporation, Moody's Investors Service and Fitch Ratings. A rating trigger event exists if our senior secured debt does not have at least two of the following ratings: (i) A- or higher from Standard & Poor's Corporation, (ii) A3 or higher from Moody's Investors Service, (iii) A- or higher from Fitch Ratings and (iv) an equivalent rating from a successor rating agency to any of the above rating agencies. If our senior secured credit ratings fall below the levels listed above, the mortgage notes on deposit at that time, which totaled $3,784 million at August 31, 2009, would be pledged as collateral rather than held on deposit. At August 31, 2009 and May 31, 2009, National Rural's senior secured debt ratings were above the rating trigger threshold.

A total of $2 billion of notes payable to the FFB at August 31, 2009 and May 31, 2009 have a second trigger requiring that a director on the National Rural board satisfies the requirements of a financial expert as defined by Section 407 of the Sarbanes-Oxley Act of 2002. A financial expert triggering event will occur if the financial expert position remains vacant for more than

90 consecutive days. If we do not satisfy the financial expert requirement, the mortgage notes on deposit at that time, which totaled $2,499 million at August 31, 2009, would be pledged as collateral rather than held on deposit. The financial expert position on National Rural's board of directors has been filled since March 2007.

(3) Foreclosed Assets

Assets received in satisfaction of loan receivables are recorded at cost and are evaluated periodically for impairment. These assets are classified on the consolidated balance sheets as foreclosed assets, net. These assets do not meet the criteria to be classified as held for sale at August 31, 2009 and May 31, 2009.

The activity for foreclosed assets is summarized below:

	Three months ended August 31,		Year ended
(dollar amounts in thousands)	2009	2008	May 31, 2009
Beginning balance	$ 48,721	$ 58,961	$ 58,961
Results of operations	587	1,246	3,774
Net cash provided by foreclosed assets	-	-	(6,000)
Market adjustment	(1,750)	-	(8,014)
Ending balance	$ 47,558	$ 60,207	$ 48,721

The balance of foreclosed assets included land development loans and limited partnership interests in certain real estate developments for all periods presented. The reduction to the fair value of the collateral supporting these land development loans during the quarter ended August 31, 2009 was primarily due to lower gas prices which decreased the fair value of the underlying collateral. During the year ended May 31, 2009, current economic conditions put a strain on cash flows for one of the land developers and their ability to make loan payments as scheduled. At January 1, 2009, this borrower's loan was put on non-accrual status. During the year ended May 31, 2009, the other land development loan was restructured to lower the interest rate due to concerns about the borrower's ability to meet all future payments based on the original loan terms. As a result, we classified both land development loans as impaired at August 31, 2009 and May 31, 2009. Subsequent to August 31, 2009, the restructured land development loan was also put on non-accrual status.

(4) Short-Term Debt and Credit Arrangements

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

(dollar amounts in thousands)	August 31, 2009	May 31, 2009
Short-term debt:		
Commercial paper sold through dealers, net of discounts	$ 1,341,777	$ 594,533
Commercial paper sold directly to members, at par	1,052,494	934,897
Commercial paper sold directly to non-members, at par	26,375	12,502
Total commercial paper	2,420,646	1,541,932
Daily liquidity fund sold directly to members	330,251	291,341
Term loan	-	200,000
Bank bid notes	225,000	255,000

Subtotal short-term debt	2,975,897	2,288,273
Long-term debt maturing within one year:		
Medium-term notes sold through dealers	267,736	1,674,760
Medium-term notes sold to members	411,624	502,396
Secured collateral trust bonds	609,991	209,985
Secured notes payable	187,800	187,800
Unsecured notes payable	4,653	4,650
Total long-term debt maturing within one year	1,481,804	2,579,591
Total short-term debt	$ 4,457,701	$ 4,867,864

We issue commercial paper for periods of one to 270 days. We also enter into short-term bank bid note agreements, which are unsecured obligations that do not require backup bank lines for liquidity purposes. We do not pay a commitment fee for bank bid notes. The commitments are generally subject to termination at the discretion of the individual banks.

In June 2009, we paid off the $200 million term loan borrowed under a credit agreement with a syndicate of banks in January 2009. The term loan was due to mature on January 21, 2010, but was paid off early without any termination fee.

Revolving Credit Agreements

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

(dollar amounts in thousands)	August 31, 2009	May 31, 2009	Termination Date	Facility fee per year (1)
Five-year agreement (2)	$ 1,125,000	$1,125,000	March 16, 2012	6 basis points
Five-year agreement (2)	1,025,000	1,025,000	March 22, 2011	6 basis points
364-day agreement	1,000,000	1,000,000	March 12, 2010	12.5 basis points
Total	$ 3,150,000	$3,150,000		

(1) Facility fee determined by National Rural's senior unsecured credit ratings based on the pricing schedules put in place at the initiation of the related agreement.
(2) Amounts include Lehman Brothers Bank, FSB's portion of the credit facility totaling $134 million allocated as follows: $76 million under the five-year facility maturing 2012, and $58 million under the five-year facility maturing in 2011. We do not expect Lehman Brothers Bank, FSB to fund its portion of the credit facility according to the agreements. See further discussion below.

We have the right under the 364-day revolving credit agreement, subject to certain terms and conditions, to increase the aggregate amount of the commitments by up to $250 million either by increasing the commitment of one or more existing lenders or by adding one or more new lenders, provided that no existing lender's commitment may be increased without the consent of the lender and administrative agent.

Both five-year agreements contain a provision under which if borrowings exceed 50 percent of total commitments, a utilization fee of five basis points must be paid on the outstanding balance.

At August 31, 2009 and May 31, 2009, we were in compliance with all covenants and conditions under our revolving credit agreements and there were no borrowings outstanding under these agreements.

In September 2008, Lehman Brothers Holdings Inc. ("LBHI") announced that it had filed a petition under Chapter 11 of the United States Bankruptcy Code with the United States Bankruptcy Court for the Southern District of New York. As an active participant in the capital markets, we had numerous business relationships with LBHI and its subsidiaries. Among those relationships, Lehman Brothers Bank, FSB ("LBB") was a participant for up to $134 million of our revolving credit facilities at August 31, 2009. We do not believe that LBB's portion of the credit facilities will be available in the future.

For calculating the required financial covenants in our revolving credit agreements, we adjust net income, senior debt and total equity to exclude the non-cash adjustments from the accounting for derivative financial instruments and foreign currency translation. The adjusted times interest earned ratio ("TIER"), as defined by the agreements, represents the interest expense adjusted to include the derivative cash settlements plus minority interest net income, plus net income prior to the cumulative effect of change in accounting principle and dividing that total by the interest expense adjusted to include the derivative cash settlements. In addition to the non-cash adjustments discussed above, senior debt also excludes RUS guaranteed loans, subordinated deferrable debt, members' subordinated certificates and minority interest. Total equity is adjusted to include subordinated deferrable debt, members' subordinated certificates and minority interest. Due to the adoption of new accounting guidance regarding noncontrolling interests on June 1, 2009, minority interest net income is included in total net income on the consolidated statements of operations and minority interest is reported as equity on the consolidated balance sheets for all periods presented. As a result, it is not necessary to adjust net income to include minority interest net income or to adjust equity to include minority interest as it was in prior periods. Senior debt includes guarantees; however, it excludes:

- guarantees for members where the long-term unsecured debt of the member is rated at least BBB+ by Standard & Poor's Corporation or Baa1 by Moody's Investors Service; and
- the payment of principal and interest by the member on the guaranteed indebtedness if covered by insurance or reinsurance provided by an insurer having an insurance financial strength rating of AAA by Standard & Poor's Corporation or a financial strength rating of Aaa by Moody's Investors Service.

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

		Actual	
	Requirement	August 31, 2009	May 31, 2009
Minimum average adjusted TIER over the six most recent fiscal quarters	1.025	1.15	1.18
Minimum adjusted TIER at fiscal year end (1)	1.05	NA	1.10
Maximum ratio of senior debt to total equity	10.00	6.75	6.90

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

The revolving credit agreements do not contain a material adverse change clause or ratings trigger that limit the banks' obligations to fund under the terms of the agreements, but we must be in compliance with the other requirements, including financial ratios, to draw down on the facilities.

(5) Long-Term Debt

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

(dollar amounts in thousands)	August 31, 2009	May 31, 2009
Unsecured long-term debt:		
Medium-term notes sold through dealers	$ 3,457,250	$ 3,469,580
Medium-term notes sold to members	227,008	220,613
Subtotal	3,684,258	3,690,193
Unamortized discount	(2,942)	(3,120)
Total unsecured medium-term notes	3,681,316	3,687,073
Unsecured notes payable	3,053,705	3,053,705
Unamortized discount	(1,642)	(1,694)
Total unsecured notes payable	3,052,063	3,052,011
Total unsecured long-term debt	6,733,379	6,739,084
Secured long-term debt:		
Collateral trust bonds	4,581,736	4,981,736
Unamortized discount	(12,555)	(12,965)
Total secured collateral trust bonds	4,569,181	4,968,771
Secured notes payable	1,637,200	1,012,200
Total secured long-term debt	6,206,381	5,980,971
Total long-term debt	$ 12,939,760	$ 12,720,055

Medium-term notes are unsecured obligations of National Rural. Collateral trust bonds are secured by the pledge of mortgage notes or eligible securities in an amount at least equal to the principal balance of the bonds outstanding. See Note 2, Loans and Commitments, for additional information on the collateral pledged to secure National Rural's collateral trust bonds.

Unsecured Notes Payable
At August 31, 2009 and May 31, 2009, we had unsecured notes payable totaling $3 billion outstanding under a bond purchase agreement with the FFB and a bond guarantee agreement with RUS as part of the funding mechanism for the REDLG program. As part of the REDLG program, we pay RUS a fee of 30 basis points per year on the total amount borrowed. At August 31, 2009, the $3 billion of unsecured notes payable issued as part of the REDLG program require us to place mortgage notes on deposit in an amount at least equal to the principal balance of the notes outstanding. See Note 2, Loans and Commitments, for additional information on the mortgage notes held on deposit and the triggering events that result in these mortgage notes becoming pledged as collateral.

Secured Notes Payable
Details about our note purchase agreements and outstanding notes payable with Farmer Mac are shown below:

(dollar amounts in thousands)		Amount Outstanding	
Note Purchase Agreement	Amount Available	August 31, 2009	May 31, 2009
December 2008 (1)	$ 500,000	$ 500,000	$