NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORP /DC/
Form 10-K
August 27, 2007

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

FORM 10-K

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

THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended May 31, 2007

OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number 1-7102

NATIONAL RURAL UTILITIES COOPERATIVE
FINANCE CORPORATION

(Exact name of registrant as specified in its charter)

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

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

2201 COOPERATIVE WAY, HERNDON, VA 20171
(Address of principal executive offices)
(Registrant's telecommunications number, including area code, is 703-709-6700)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which listed	Title of each class	Name of each exchange on which listed
6.20% Collateral Trust Bonds, due 2008	NYSE	7.35% Collateral Trust Bonds, due 2026	NYSE

5.75% Collateral Trust Bonds, due 2008	NYSE	6.75% Subordinated Notes, due 2043	NYSE
5.70% Collateral Trust Bonds, due 2010	NYSE	6.10% Subordinated Notes, due 2044	NYSE
7.20% Collateral Trust Bonds, due 2015	NYSE	5.95% Subordinated Notes, due 2045	NYSE
6.55% Collateral Trust Bonds, due 2018	NYSE		

Indicated by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ¨ No x

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained to the best of the registrant's knowledge in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.[x]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨   Accelerated filer ¨   Non-accelerated filer x

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 cooperative and consequently, does not issue any equity capital stock.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Form 10-K contains forward-looking statements within the meaning of 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 that address expectations or projections about the future, including statements about loan growth, the adequacy of the loan loss allowance, net income growth, leverage and debt to equity ratios, and borrower financial performance 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 differ materially from those set forth in the forward-looking statements. Factors that could cause future results to vary from current expectations include, but are not limited to, general economic conditions, legislative changes, governmental monetary and fiscal policies, changes in tax policies, changes in interest rates, the interest expense, demand for our loan products, changes in the quality or composition of our loan and investment portfolios, changes in accounting principles, policies or guidelines, and other economic and governmental factors affecting our operations. Some of these and other factors are discussed in our annual and quarterly reports previously filed with the 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.

The information contained in this section should be read in conjunction with our consolidated financial statements and related notes and the information contained elsewhere in this Form 10-K, including that set forth under Item 1A, *Risk Factors*.

PART I

Item 1. Business.

General

National Rural Utilities Cooperative Finance Corporation ("CFC" or "the Company") is a private, not-for-profit cooperative association incorporated under the laws of the District of Columbia in April 1969. The principal purpose of CFC 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. CFC 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. CFC also provides its members with credit enhancements in the form of letters of credit and guarantees of debt obligations. CFC is exempt from payment of federal income taxes under the provisions of Section 501(c)(4) of the Internal Revenue Code. CFC is a not-for-profit member-owned finance cooperative, thus its objective is not to maximize its net income, but to offer its members low cost financial products and services consistent with sound financial management. CFC's internet address is www.nrucfc.coop, where under "Investors," copies can be found of this annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments thereto, all of which CFC makes available as soon as reasonably practicable after the report is filed with the SEC. Information posted on CFC's website is not incorporated by reference into this Form 10-K.

For financial statement purposes, the results of operations and financial condition of CFC are consolidated with and include Rural Telephone Finance Cooperative ("RTFC") and National Cooperative Services Corporation ("NCSC"). Unless stated otherwise, references to the Company relate to the consolidation of CFC, RTFC, NCSC and certain entities controlled by CFC and created to hold foreclosed assets and effect loan securitization transactions. CFC also reports the operations for each of CFC, RTFC and NCSC as separate segments.

RTFC is a private not-for-profit cooperative association incorporated under the laws of the District of Columbia. The principal purpose of RTFC is to provide and arrange financing for its rural telecommunications members and their affiliates. CFC is the sole lender to and manages the lending and financial affairs of RTFC through a long-term management agreement. Under a guarantee agreement, RTFC pays CFC a fee in exchange for which CFC reimburses RTFC for loan losses. RTFC is headquartered with CFC 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.

NCSC was incorporated in 1981 in the District of Columbia as a private non-profit cooperative association. The principal purpose of NCSC is to provide financing to the for-profit and non-profit entities that are owned, operated or controlled by, or provide substantial benefit to, members of CFC. NCSC also markets, through its cooperative members, a consumer loan program for home improvements and an affinity credit card program. NCSC's membership consists of CFC and distribution systems that are members of CFC or are eligible for such membership. CFC 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. Under a guarantee agreement, NCSC pays CFC a fee in exchange for which CFC reimburses NCSC for loan losses, excluding losses in the consumer loan program. NCSC is headquartered with CFC in Herndon, Virginia. NCSC is a taxable corporation.

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Members

The Company's consolidated membership was 1,544 as of May 31, 2007 including 899 utility members, the majority of which are consumer-owned electric cooperatives, 513 telecommunications members, 66 service members and 66 associates in 49 states, the District of Columbia and two U.S. territories. The utility members included 830 distribution systems and 69 generation and transmission ("power supply") systems. Memberships between CFC, RTFC and NCSC have been eliminated in consolidation.

CFC currently has four classes of electric members:

- Class A - cooperative or not-for-profit distribution systems;
- Class B - cooperative or not-for-profit power supply systems;
- Class C - statewide and regional associations wholly-owned or controlled by Class A or Class B members; and
- Class D - national associations of cooperatives.

The associates are not-for-profit entities organized on a cooperative basis which are owned, controlled or operated by Class A, B or C members and which provide non-electric services primarily for the benefit of ultimate consumers. Associates are not entitled to vote at any meeting of the members and are not eligible to be represented on CFC's board of directors. All references to members within this document include members and associates.

Membership in RTFC is limited to commercial (for-profit) or cooperative (not-for-profit) telecommunications systems that receive or are eligible to receive loans or other assistance from RUS, and that are engaged (or plan to be engaged) in providing telecommunications services to ultimate users.

Membership in NCSC is limited to CFC and organizations that are Class A members of CFC or are eligible to be Class A members of CFC.

In many cases, the residential and commercial customers of CFC's electric members are also the customers of RTFC's telecommunications members, as the service territories of the electric and telecommunications members overlap in many of the rural areas of the United States.

Set forth below is a table showing by state or U.S. territory the total number of CFC, RTFC and NCSC members, the percentage of total loans and the percentage of total loans and guarantees outstanding at May 31, 2007.

State/Territory	Number of Members	Loan %	Loan and Guarantee %	State/Territory	Number of Members	Loan %	Loan and Guarantee %
Alabama	30	1.92%	2.19%	Missouri	65	3.48%	3.73%
Alaska	30	1.85%	1.76%	Montana	40	0.73%	0.74%
American Samoa	1	-	-	Nebraska	40	0.09%	0.09%
Arizona	27	0.99%	1.13%	Nevada	7	0.81%	0.80%
Arkansas	30	2.86%	2.76%	New Hampshire	4	0.83%	0.96%
California	11	0.15%	0.15%	New Jersey	1	0.10%	0.09%
Colorado	40	5.09%	5.09%	New Mexico	25	0.18%	0.17%
Connecticut	1	1.10%	1.04%	New York	21	0.11%	0.10%
Delaware	1	0.22%	0.21%	North Carolina	44	2.86%	3.23%
District of Columbia	4	0.05%	0.16%	North Dakota	34	0.43%	0.44%
Florida	19	3.40%	3.24%	Ohio	42	2.15%	2.06%
Georgia	68	8.64%	8.29%	Oklahoma	49	2.65%	2.52%
Guam	1	-	-	Oregon	40	1.69%	1.74%

Hawaii	1	0.04%	0.04%	Pennsylvania	25	2.07%	2.05%
Idaho	17	0.93%	0.89%	South Carolina	38	2.63%	2.52%
Illinois	52	3.00%	2.83%	South Dakota	46	0.89%	0.84%
Indiana	53	2.65%	2.51%	Tennessee	29	0.53%	0.50%
Iowa	118	2.66%	2.55%	Texas	109	14.44%	14.43%
Kansas	49	4.69%	4.71%	Utah	11	3.12%	3.04%
Kentucky	33	1.96%	2.50%	Vermont	7	0.42%	0.41%
Louisiana	17	1.77%	1.69%	Virgin Islands	0	2.72%	2.57%
Maine	6	0.05%	0.05%	Virginia	27	1.02%	0.98%
Maryland	2	1.14%	1.21%	Washington	19	0.61%	0.70%
Massachusetts	1	-	-	West Virginia	4	0.03%	0.03%
Michigan	27	1.50%	1.42%	Wisconsin	62	2.04%	1.92%
Minnesota	75	4.04%	3.87%	Wyoming	15	0.65%	0.68%
Mississippi	26	2.02%	2.37%	Total	1,544	100.00%	100.00%

Distribution Systems

Distribution systems are utilities engaged in retail sales of electricity to consumers in their service areas. Most distribution systems have all-requirements power purchase contracts with their power supply systems, which are owned and controlled by the member distribution systems. Wholesale power for resale also comes from other sources, including power supply system contracts with government agencies, investor-owned utilities and other entities, and in rare cases, the distribution system's own generating facilities.

Wholesale power supply contracts ordinarily guarantee neither an uninterrupted supply nor a constant cost of power. Contracts with RUS-financed power supply systems (which generally require the distribution system to purchase all its power requirements from the power supply system) provide for rate increases to pass along increases in sellers' costs. The wholesale power contracts permit the power supply system, subject to approval by RUS and, in certain circumstances, regulatory agencies, to establish rates to its members so as to produce revenues sufficient, with revenues from all other sources, to meet the costs of operation and maintenance (including replacements, insurance, taxes and administrative and general overhead expenses) of all generating, transmission and related facilities, to pay the cost of any power and energy purchased for resale, to pay the costs of generation and transmission, to make all payments on account of all indebtedness and lease obligations of the power supply system and to provide for the establishment and maintenance of reasonable reserves. The board of directors of the power supply system may review the rates under the wholesale power contracts at least annually.

Power contracts with investor-owned utilities and power supply systems which do not borrow from RUS generally have rates subject to regulation by the Federal Energy Regulatory Commission ("FERC"). Contracts with federal agencies generally permit rate changes by the selling agency (subject, in some cases, to federal regulatory approval).

Power Supply Systems

Power supply systems are utilities that purchase or generate electric power and provide it on a wholesale basis to distribution systems for delivery to the ultimate retail consumer. Of the 61 operating power supply systems financed in whole or in part by RUS or CFC at December 31, 2005 (the most recent year for which data is available), 60 were cooperatives owned directly or indirectly by groups of distribution systems and one was government owned. Of this number, 34 had generating capacity of at least 100 megawatts, 12 had less than 100 megawatts of generating capacity and 14 had no generating capacity. The systems with no generating capacity generally operated transmission lines to supply certain distribution systems. Certain other power supply systems have been formed but do not yet own generating or transmission facilities.

Service Organizations and Associate Systems

Service organizations include the National Rural Electric Cooperative Association ("NRECA"), statewide and regional cooperative associations. NRECA represents cooperatives nationally.

Associates include organizations that are owned, controlled or operated by Class A, B or C members and that provide non-electric services primarily for the benefit of ultimate consumers.

Telecommunications Systems

Telecommunications systems include not-for-profit cooperative organizations and for-profit commercial organizations that primarily provide local exchange and access telecommunications services to rural areas.

Independent rural telecommunications companies provide service throughout many of the rural areas of the United States. These companies, which number approximately 1,300, are called independent because they are not affiliated with Verizon, AT&T or Qwest. Included in the 1,300 total are approximately 250 not-for-profit cooperative telecommunications companies. The majority of these independent rural telecommunications companies are family-owned or privately-held commercial companies. Approximately 20 of these commercial companies are publicly traded or issue bonds publicly.

Rural telecommunications companies (including all local exchange carriers ("LECs") other than Verizon, AT&T, Qwest, Cincinnati Bell and Embarq (formerly Sprint's local exchange properties)) comprise a relatively small sector (less than 15%) of a local exchange telecommunications industry that provides service to over 172 million access lines. These rural companies range in size from fewer than 100 customers to more than one million. Rural telecommunications companies' annual operating revenues range from less than $100,000 to over $2 billion. In addition to basic local exchange and access telecommunications service, most independents offer other communications services including wireless telephone, cable television and internet access. Most rural telecommunications companies' networks incorporate digital switching, fiber optics, internet protocol telephony and other advanced technologies.

Loan Programs

Set forth below is a table showing the weighted average loans outstanding to borrowers and the weighted average interest rates thereon by loan program and by segment during fiscal years ended May 31:

	2007		2006	
	Weighted average loans outstanding	Weighted average interest rate	Weighted average loans outstanding	Weighted average interest rate
(Dollar amounts in thousands)				
Total by loan type: (1)				
Long-term fixed rate loans	$14,323,272	5.87%	$13,672,251	5.64%
Long-term variable rate loans	1,433,484	7.58%	2,351,131	6.43%
Loans guaranteed by RUS	258,407	5.59%	262,852	5.34%
Short-term loans	1,028,585	7.06%	948,774	6.07%
Non-performing loans	534,733	0.02%	570,196	0.01%
Restructured loans	614,580	0.61%	599,779	0.08%
Total loans	$18,193,061	5.79%	$18,404,983	5.48%
Total by segment:				
CFC	$15,803,285	5.80%	$15,604,657	5.43%
RTFC	1,993,672	5.30%	2,356,449	5.50%
NCSC	396,104	8.00%	443,877	7.08%
Total	$18,193,061	5.79%	$18,404,983	5.48%

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

Total loans outstanding by state or U.S. territory based on the location of the system's headquarters are summarized below at
May 31:

(in thousands)

State/Territory	**2007**	**2006**	**2005**	**State/Territory**	**2007**	**2006**	**2005**
Alabama	$ 347,723	$ 355,420	$ 362,305	Montana	$ 132,603	$ 147,731	$ 164,715
Alaska	335,352	333,716	330,827	Nebraska	16,447	14,149	15,635
American Samoa	769	1,604	2,765	Nevada	147,401	137,701	141,571
Arizona	178,659	169,754	165,664	New Hampshire	149,496	164,651	178,740
Arkansas	518,273	549,552	555,055	New Jersey	18,217	18,211	19,438
California	27,283	24,362	20,894	New Mexico	32,344	36,528	34,223
Colorado	922,558	876,100	873,413	New York	19,844	21,782	19,621
Connecticut	200,000	200,000	200,000	North Carolina	519,214	522,194	1,024,134
Delaware	39,582	23,842	19,809	North Dakota	77,072	77,002	81,977
District of Columbia	9,717	9,908	25,526	Ohio	390,350	410,346	415,227
Florida	617,010	659,416	636,792	Oklahoma	480,536	490,351	492,462

Georgia	1,566,308	1,557,675	1,573,770	Oregon	305,506	305,961	314,137
Hawaii	7,157	7,500	7,834	Pennsylvania	376,193	438,914	265,930
Idaho	168,253	165,035	170,820	South Carolina	476,139	501,990	525,285
Illinois	543,389	509,391	543,196	South Dakota	161,247	169,335	173,074
Indiana	481,243	432,953	373,185	Tennessee	96,073	111,043	125,688
Iowa	482,513	468,236	492,095	Texas	2,618,010	2,877,586	2,904,185
Kansas	849,864	593,670	539,392	Utah	565,768	580,472	547,288
Kentucky	355,503	335,551	454,976	Vermont	75,905	81,761	87,595
Louisiana	320,765	382,505	337,741	Virgin Islands	492,795	488,392	479,196
Maine	9,884	11,737	12,954	Virginia	184,986	209,153	218,801
Maryland	206,491	176,797	169,581	Washington	110,907	102,128	99,562
Michigan	271,541	294,162	301,822	West Virginia	5,355	7,700	8,171
Minnesota	731,883	744,941	895,976	Wisconsin	369,427	348,351	339,207
Mississippi	366,989	426,634	426,895	Wyoming	117,374	117,098	139,618
Missouri	630,289	669,914	663,301	Total	$18,128,207	$18,360,905	$18,972,068

The Company's loan portfolio is widely dispersed throughout the United States and its territories, including 48 states, the District of Columbia, American Samoa and the U.S. Virgin Islands. At May 31, 2007, 2006 and 2005, loans outstanding to borrowers located in any one state or territory did not exceed 15%, 16% and 16%, respectively, of total loans outstanding.

Interest Rates on Loans

CFC's goal as a not-for-profit cooperatively-owned finance company is to set rates at levels that will provide its members with the lowest cost financing while maintaining sound financial results as required to obtain high credit ratings on its debt instruments. CFC sets its interest rates primarily based on its cost of funding, as well as general and administrative expenses, the loan loss provision and a reasonable level of earnings. Various discounts, which reduce the stated interest rates, are available to borrowers meeting certain criteria related to business type, performance, volume and whether CFC is their sole mortgage holder.

CFC Loan Programs

Long-Term Loans

Long-term loans are generally for terms of up to 35 years and can be either amortizing or bullet loans with serial payment structures. These loans finance electric plant and equipment which typically have a useful life equal to or in excess of the loan maturity. A borrower can select a fixed interest rate for periods of one to 35 years or a variable rate. Upon the expiration of the selected fixed interest rate term, the borrower may select another fixed rate term or the variable rate. CFC sets long-term fixed rates daily and the long-term variable rate is set on the first business day of each month. The fixed rate on a loan is determined on the day the loan is advanced or repriced based on the rate term selected. A borrower may divide its loan into various tranches. The borrower then has the option of selecting a fixed or variable interest rate for each tranche.

In addition to CFC’s customary loan standards, to be eligible for long-term loan advances, distribution systems generally must maintain an average modified debt service coverage ratio ("MDSC"), as defined in the loan agreement, of 1.35 or greater. Similarly, power supply systems generally must maintain an average times interest earned ratio ("TIER") and MDSC, as defined in the loan agreement, of 1.0 or greater. These are general guidelines only and CFC has in the past and may in the future make long-term loans to distribution and power supply systems that do not meet these criteria.

Short-Term Loans

CFC’s short-term loans are line of credit loans and generally are advanced only at a variable interest rate. The line of credit variable interest rate is set on the first business day of each month. The principal amount of line of credit loans with maturities of greater than one year generally must be paid down to a zero outstanding principal balance for five consecutive days during each 12-month period.

Interim financing line of credit loans are also made available to CFC members that have a loan application pending with RUS and have received approval from RUS to obtain interim financing. Advances under these interim facilities are made with the agreement that they will be repaid with advances from RUS long-term loans.

RTFC Loan Programs

The RTFC loan portfolio is concentrated in the core rural local exchange carrier ("RLEC") segment of the telecommunications market. RLECs are characterized by the low population density of their service territories. Services are generally delivered over networks that include fiber optic cable and digital switching. There is generally a significant barrier to competitive entry.

The businesses to which the remaining RTFC loans have been made are generally supporting the operations of the RLECs and are owned, operated or controlled by RLECs. Many such loans are supported by payment guarantees from the sponsoring RLECs.

Long-Term Loans

RTFC makes long-term loans to rural telecommunications companies and their affiliates for the acquisition, construction or upgrade of wireline telecommunications systems, wireless telecommunications systems, fiber optic networks, cable television systems and other corporate purposes. Long-term loans are generally for periods of up to 15 years. Loans may be advanced at a fixed or variable interest rate. Fixed rates are generally available for periods from one year to 15 years. Upon the expiration of the selected fixed interest rate term, the borrower may select another fixed rate term or a variable rate. Long-term fixed rates for telecommunications loans are set daily and the long-term variable rate is set on the first business day of each month. The fixed rate on a loan is determined on the day the loan is advanced or converted to a fixed rate based on the term selected. A borrower may divide its loan into various tranches. The borrower then has the option of selecting a fixed or variable interest rate for each tranche.

To borrow from RTFC, a wireline telecommunications system generally must be able to demonstrate the ability to achieve and maintain an annual debt service coverage ratio ("DSC") and an annual TIER of 1.25 and 1.50, respectively. To borrow from RTFC, a cable television system, fiber optic network or wireless telecommunications system generally must be able to demonstrate the ability to achieve and maintain an annual DSC of 1.25. Loans made to start-up ventures using emerging technologies are evaluated based on the quality of the business plan, experience of the management team and the level and quality of credit support from established companies. Based on the business plan, specific covenants are developed for each transaction which require performance at levels deemed sufficient to repay the RTFC obligations under the approved terms.

Short-Term Loans

RTFC provides line of credit loans to telecommunications systems for periods of up to five years. These line of credit loans are typically in the form of a revolving line of credit, which generally requires the borrower to pay off the principal balance for five consecutive business days at least once during each 12-month period. These line of credit loans may be provided on a secured or unsecured basis and are designed primarily to assist borrowers with liquidity and cash management.

Interim financing line of credit loans are also made available to RTFC members that have a loan application pending with RUS and have received approval from RUS to obtain interim financing. These loans are for terms up to 24 months and the borrower must repay the RTFC loan with advances from the RUS long-term loans.

NCSC Loan Programs

NCSC makes long-term and short-term loans to rural utility members and organizations affiliated with its members. Loans may be secured or unsecured. The loans to the affiliated organizations may have a guarantee of repayment to NCSC from the CFC member cooperative with which it is affiliated.

Lease and General Loan Program

NCSC provided financing for the purchase of utility plant and/or related equipment, in some cases by a third party in a sale/leaseback transaction. Collateral for these loans consists of a mortgage on the leased asset, utility plant and/or related equipment. NCSC is not a party to these lease agreements. NCSC no longer provides new financing of this type.

Associate Member Loan Program

NCSC provides financing to for-profit or not-for-profit affiliated entities of member cooperatives for economic and community development purposes. Collateral for these loans generally consists of a first mortgage lien on the assets of the associate member and/or project. These loans are also generally guaranteed by the sponsoring cooperative.

RUS Guaranteed Loans for Rural Electric Systems

CFC may participate as an eligible lender in the RUS loan guarantee program under the terms and conditions of a master loan guarantee and servicing agreement between RUS and CFC. Under this agreement, CFC may make long-term secured loans to eligible members for periods of up to 35 years, at fixed or variable rates established by CFC. RUS guarantees the principal and interest payments on the notes evidencing such loans. At May 31, 2007, CFC had $219 million of loans outstanding under this program. In addition, at May 31, 2007, CFC was holding certificates totaling $37 million representing interests in trusts holding RUS guaranteed loans.

Conversion of Loans

A borrower may convert a long-term loan from a variable interest rate to a fixed interest rate at any time without a fee. Such conversion will be effective on the first day of the following month. Generally, a borrower may convert from a fixed rate to another fixed rate or to a variable rate at any time, subject to a fee in most instances. The fee on the conversion of a fixed interest rate to a variable interest rate is 25 basis points plus a make-whole premium, if applicable, per current loan policies.

Prepayment of Loans

Generally, borrowers may prepay long-term loans at any time, subject to the payment of a prepayment fee of 33 to 50 basis points and a make-whole premium, if applicable. Line of credit loans may be repaid at any time without a premium.

Loan Security

Except when providing short-term loans, the Company typically lends to its 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 revenues of the borrower with exceptions typical in utility mortgages. Short-term loans are generally unsecured lines of credit.

The following tables summarize the Company's secured and unsecured loans outstanding by loan program and by segment at May 31:

(Dollar amounts in thousands)	2007				2006			
Total by loan program:	Secured	%	Unsecured	%	Secured	%	Unsecured	%
Long-term fixed rate loans	$14,180,956	97%	$ 482,384	3%	$13,984,404	96%	$ 562,446	4%
Long-term variable rate loans	1,865,821	94%	127,713	6%	2,414,737	96%	109,985	4%
Loans guaranteed by RUS	255,903	100%	-	-	261,330	100%	-	-
Short-term loans	191,231	16%	1,024,199	84%	146,835	14%	881,168	86%
Total loans	$16,493,911	91%	$ 1,634,296	9%	$16,807,306	92%	$ 1,553,599	8%
CFC	$14,462,448	92%	$ 1,342,842	8%	$14,575,691	92%	$ 1,218,681	8%
RTFC	1,630,079	88%	230,300	12%	1,921,635	89%	240,829	11%
NCSC	401,384	87%	61,154	13%	309,980	77%	94,089	23%
Total loans	$16,493,911	91%	$ 1,634,296	9%	$16,807,306	92%	$ 1,553,599	8%

Guarantee Programs

The Company uses the same credit policies and monitoring procedures in providing guarantees as it does for loans and commitments. The following chart provides a breakout of guarantees outstanding by type at May 31:

(in thousands)	2007	2006
Long-term tax-exempt bonds	$ 526,185	$ 607,655
Indemnifications of tax benefit transfers	107,741	123,544
Letters of credit	365,766	272,450
Other guarantees	74,682	75,331
Total	$ 1,074,374	$ 1,078,980

Members' interest expense for the years ended May 31, 2007 and 2006 on debt obligations guaranteed by the Company was approximately $20 million for each year.

Guarantees of Long-Term Tax-Exempt Bonds

The Company has guaranteed debt issued in connection with the construction or acquisition by its members of pollution control, solid waste disposal, industrial development and electric distribution facilities. Governmental authorities issue such debt and the interest thereon is exempt from federal taxation. The proceeds of the offering are made available to the member system, which in turn is obligated to pay the governmental authority amounts sufficient to service the debt. The debt, which is guaranteed by the Company, may include short- and long-term obligations.

In the event of a default by a system for non-payment of debt service, the Company is obligated to pay, after available debt service reserve funds have been exhausted, scheduled debt service under its guarantee. The bond issue may not be accelerated due to such non-payment by the system so long as the Company performs under its guarantee. The system is required to repay, on demand, any amount advanced by the Company pursuant to its guarantee. This repayment obligation is secured on a pari passu basis with other lenders (including, in most cases, RUS), by a lien on substantially all of the system’s assets. If the security instrument is a common mortgage with RUS, then in general, the Company may not exercise remedies thereunder for up to two years following default. However, if the debt is accelerated under the common mortgage because of a determination that the interest thereon is not tax-exempt, the system's obligation to reimburse the Company for any guarantee payments will be treated as a long-term loan. The system is required to pay to the Company initial and/or on-going guarantee fees in connection with these transactions.

Certain guaranteed long-term debt bears interest at variable rates which are adjusted at intervals of one to 270 days, weekly, each five weeks or semi-annually to a level expected to permit their resale or auction at par. At the option of the member on whose behalf it is issued, and provided funding sources are available, rates on such debt may be fixed until maturity. Holders have the right to tender the debt for purchase at par at the time rates are reset when the debt bears interest at a variable rate and the Company has committed to purchase debt so tendered if it cannot otherwise be remarketed. If the Company held the securities, the cooperative would pay interest to the Company at its short-term rate. Since the inception of the program in the mid-1980s, all bonds have been successfully remarketed and thus, the Company has not been required to purchase any bonds.

Guarantees of Tax Benefit Transfers

The Company also has guaranteed members' obligations to indemnify against loss of tax benefits in certain tax benefit transfers that occurred in 1981 and 1982. A member's obligation to reimburse the Company for any guarantee payments would be treated as a long-term loan, secured on a pari passu basis with RUS by a first lien on substantially all the member's property to the extent of any cash received by the member at the outset of the transaction. The remainder would be treated as a short-term loan secured by a subordinated mortgage on substantially all of the member's property. Due to changes in federal tax law, no guarantees of this nature have been put in place since 1982. The maturities for this type of guarantee run through 2015.

Letters of Credit

The Company issues irrevocable letters of credit to support members' obligations to energy marketers, other third parties and to the Rural Business and Cooperative Development Service. Letters of credit are generally issued on an unsecured basis and with such issuance fees as may be determined from time to time. Each letter of credit issued by CFC is supported by a reimbursement agreement with the member on whose behalf the letter of credit was issued. In the event a beneficiary draws on a letter of credit, the agreement generally requires the member to reimburse the Company within one year from the date of the draw, with interest accruing from such date at the Company's short-term variable rate of interest.

Other Guarantees

The Company may provide other guarantees as requested by its members. Such guarantees may be made on a secured or unsecured basis with guarantee fees set to cover the Company's general and administrative expenses, a provision for losses and a reasonable margin.

The following chart summarizes total guarantees by segment at May 31:

(Dollar amounts in thousands)				
CFC:	2007		2006	
Distribution	$ 211,320	20%	$ 70,166	7%
Power supply	797,009	74%	921,930	85%
Statewide and associate	25,359	2%	32,873	3%
CFC Total	1,033,688	96%	1,024,969	95%
NCSC	40,686	4%	54,011	5%
Total	$1,074,374	100%	$1,078,980	100%

Total guarantees outstanding, by state and territory based on the location of the system's headquarters, are summarized as follows at May 31:

(in thousands)	2007	2006	2005		2007	2006	2005
Alabama	$ 72,348	$ 22,250	$ 22,450	Montana	$ 9,029	$ 145	$ -
Alaska	1,900	1,800	3,320	Nebraska	6	-	-
Arizona	38,301	43,699	45,869	Nevada	5,400	-	-
Arkansas	12,027	15,921	19,776	New Hampshire	34,550	9,550	10,500
California	1,010	-	-	New Mexico	1,020	1,016	1,000
Colorado	54,236	55,131	55,744	North Carolina	100,630	107,817	100,854
	20,998	21,428	30,248	North Dakota	7,115	-	-

District of Columbia							
Florida	4,623	100,038	108,385	Ohio	5,500	2,000	1,000
Georgia	26,027	35,283	-	Oklahoma	3,056	4,358	4,930
Idaho	3,173	-	-	Oregon	29,439	24,922	24,880
Illinois	219	225	633	Pennsylvania	17,519	18,307	21,021
Indiana	7	911	95,900	South Carolina	7,819	50	-
Iowa	8,240	8,517	5,708	South Dakota	6	-	-
Kansas	55,472	42,561	35,632	Tennessee	296	295	295
Kentucky	124,013	121,864	132,115	Texas	152,307	167,881	143,682
Louisiana	4,733	4,778	4,728	Utah	17,193	20,594	41,126
Maine	1	-	-	Vermont	3,500	1,250	1,250
Maryland	25,266	24,800	-	Virginia	3,935	4,133	3,603
Michigan	2,123	1,163	1,207	Washington	23,171	250	-
Minnesota	10,585	76,010	86,372	Wisconsin	32	322	274
Mississippi	88,312	37,267	41,437	Wyoming	13,969	9,370	9,595
Missouri	85,268	93,074	104,218	Total	$1,074,374	$1,078,980	$1,157,752

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Disaster Recovery

CFC has had a comprehensive disaster recovery and business continuity plan in place since May of 2001. The plan includes a duplication of CFC's production information systems at an off-site facility coupled with an extensive business recovery plan to utilize those remote systems. CFC's production data is replicated in real time to the recovery site 24 hours a day, 7 days a week. The plan also includes steps for each of CFC's operating groups to conduct business with a view to minimizing disruption for customers. CFC contracts with an external vendor for the facilities to house the CFC owned backup systems as well as office space and related office equipment.

Tax Status

In 1969, CFC obtained a ruling from the Internal Revenue Service recognizing CFC's exemption from the payment of federal income taxes under Section 501(c)(4) of the Internal Revenue Code. Such exempt status could be revoked as a result of changes in legislation or in administrative policy or as a result of changes in CFC's business. CFC believes that its operations have not changed materially from those described to the Internal Revenue Service in its exemption filing. RTFC is a taxable cooperative under Subchapter T of the Internal Revenue Code. As long as RTFC continues to qualify under Subchapter T of the Internal Revenue Code, it is allowed a deduction from taxable income for the amount of net income allocated to its members. RTFC pays income tax based on its net income, excluding net income allocated to its members. NCSC is a taxable corporation. NCSC pays income tax annually based on its net income for the period.

Investment Policy

Surplus funds are invested pursuant to policies adopted by CFC's board of directors. Under present policy, surplus funds may be invested in direct obligations of, or guaranteed by, the United States or agencies thereof or other highly liquid investment grade paper. Current investments may include highly-rated securities such as commercial paper, obligations of foreign governments, Eurodollar deposits, bankers' acceptances, bank letters of credit, certificates of deposit or working capital acceptances. The policy also permits investments in certain types of repurchase agreements with highly rated financial institutions, whereby the assets consist of eligible securities of a type listed above set aside in a segregated account.

Employees

At May 31, 2007, CFC had 218 employees, including financial and legal personnel, management specialists, credit analysts, accountants and support staff. CFC believes that its relations with its employees are good.

CFC Lending Competition

CFC competes with other lenders on price, the variety of financing options offered and additional services provided to its member/owners. CFC is primarily in competition with other banks for the business of its members. The primary bank competitor is CoBank, ACB ("CoBank"), a government sponsored enterprise and member of the Farm Credit System whose status as such gives it the ability to offer lower interest rates in select situations. In addition, there are some members that are large enough to obtain a credit rating and access the capital markets for funding. In these cases, CFC is competing with the pricing and funding options the member is able to obtain in the capital markets. CFC attempts to minimize the impact of competition by offering a variety of loan options and complimentary services and by leveraging the working relationship that it has with the majority of the members for over 35 years.

RUS is generally the members' first financing option as it is able to offer members interest rates that are generally lower than the rates CFC and the other banks are able to offer. However, CFC and other banks do compete for bridge loans in anticipation of long-term funding from RUS, the portion of a loan that RUS is not able to provide, loans to members that cannot borrow from RUS and loans to members that have elected not to borrow from RUS.

According to December 31, 2005 financial data (the latest full calendar year for which this data is available as of the date of filing this Form 10-K) provided to CFC by its 812 reporting electric cooperative distribution and 60 reporting power supply systems, those entities had a total of $51 billion in long-term debt outstanding at December 31, 2005. RUS is the dominant lender to the electric cooperative industry with $29 billion or 57% of the total outstanding debt for the 872 systems reporting 2005 results to CFC. At December 31, 2005, CFC had a total of $16 billion of long-term exposure to its distribution and power supply member systems, including $15 billion of long-term loans and $1 billion of guarantees. CFC's $16 billion long-term exposure represented 31% of the total long-term debt to these electric systems. The remaining $6 billion or 12% was borrowed from other sources.

At December 31, 2006, CFC had a total of $16 billion of long-term exposure to its distribution and power supply member systems, including $15 billion of long-term loans and $1 billion of guarantees.

The competitive market for providing credit to the rural telecommunications industry is difficult to quantify, since many rural telecommunications companies are not RUS borrowers. At December 31, 2006, RUS had a total of approximately $3.7 billion outstanding to telecommunications borrowers. The Rural Telephone Bank ("RTB") is expected to be fully liquidated by November 2007 resulting in the transfer of the RTB loan portfolio to RUS. RTFC is not in direct competition with RUS, but rather competes with other lenders for supplemental lending and for the full lending requirement of the rural telecommunications companies that have decided not to borrow from RUS or for projects not eligible for RUS financing. RTFC's competition includes commercial banks, CoBank and insurance companies. At December 31, 2006, RTFC had a total of $1.9 billion in long-term loans outstanding to telecommunications borrowers.

Member Regulation and Competition

Electric Systems

The movement toward retail electric competition has faltered. The electric utility industry has settled into a "hybrid" model in which there are significant differences in the regulatory approaches followed in different states and regions. At October 31, 2005 (the latest comprehensive, and we believe still accurate, information available), customer choice has been implemented in 17 states. Those states were Arizona, Connecticut, Delaware, Illinois, Maine, Maryland, Massachusetts, Michigan, New Hampshire, New Jersey, New York, Ohio, Oregon, Pennsylvania, Rhode Island, Texas and Virginia (although Virginia passed legislation in 2007 to re-regulate the distribution and sale of electricity). Of the remaining states, customer choice was not under consideration in 26 states, delayed in four states (Montana, Nevada, Oklahoma, and West Virginia), repealed in two states (Arkansas and New Mexico), and suspended in one state (California). However, several of the states that had implemented customer choice are currently reconsidering their move to customer choice.

In the 17 states where customer choice has been implemented, the Company had a total of 240 electric members (185 distribution, 22 power supply and 33 statewide and associates) and $5,082 million of loans to electric systems at May 31, 2007. In New York, where the Company has five electric members and $8 million of loans to electric systems, cooperatives are not required to file competition plans with the state utility commission. In Michigan, where the Company has 13 electric members and $243 million in loans, the starting date for customer choice has been delayed. The Company continues to believe that the distribution systems, which comprise the majority of its membership and loan exposure, will not be materially impacted by customer choice. In general, even in those states where customers have a choice of alternative energy suppliers, very few customers have switched from the traditional supplier.

In addition, in five of the 17 states where customer choice has been implemented, cooperatives may decide whether to "opt in" to competition or retain a monopoly position with respect to energy sales. Those states are Illinois, New Jersey, Ohio, Oregon and Texas. As of May 31, 2007, CFC had loans outstanding in the amount of $3,747 million in those states. Even if customers choose to purchase energy from an alternative supplier, the distribution systems own the lines to the customer and it would not be feasible for a competitor to build a second line to serve the same customers in almost all situations. Therefore, the distribution systems will still be charging a fee or access tariff for the service of delivering power regardless of who supplies the power. The impact of customer choice on power supply systems cannot be determined until final rules have been approved in each state and on the federal level.

Even in states where customer choice laws have been passed, there are many factors that may delay or influence the choices that customers have available to them and the timing of competition for cooperatives. One such factor will be the level of fees that systems will be allowed to charge other utilities for use of their transmission and distribution system. Other issues that may further delay competition include, but are not limited to, the following:

- Ability of cooperatives to "opt out" of the provisions of the customer choice laws in some states;
- Utilities in many states may still be regulated regarding rates on non-competitive services, such as distribution;
- Many states will still regulate the securities issued by utilities, including cooperatives;

- FERC regulation of rates as well as terms and conditions of transmission service;
- Reconciling the differences between state laws, such that out-of-state utilities can compete with in-state utilities; and
- The fact that few competitors have much interest in serving residential or rural customers.

In addition to customer choice laws, some state agencies regulate electric cooperatives with regard to rates and borrowing. There are 16 states that regulate the rates electric systems charge; of these states, two states have partial oversight authority over the cooperatives' rates, but not the specific authority to set rates. Nine states allow cooperatives the right to opt in or out of state regulation. There are 20 states that regulate electric systems regarding the issuance of long-term debt and one of these states regulates both the issuance of short-term and long-term debt. FERC also has jurisdiction to regulate wholesale rates, terms and conditions of service and the issuance of securities by public utilities within its jurisdiction, which presently includes only a few cooperatives.

With the enactment of the Energy Policy Act of 2005 in August 2005, the definition of a public utility has been modified to exclude cooperatives currently financed by RUS and non-RUS financed cooperatives provided that the non-RUS financed cooperatives have total annual sales less than four million Mwh. The Energy Policy Act of 2005 effectively provides a statutory exemption from FERC regulation as public utilities for essentially all distribution cooperatives, although such cooperatives may be subject to other aspects of FERC regulation in certain circumstances.

Telecommunications Systems
RTFC member telecommunications systems generally are regulated at the state and federal levels. Most state regulatory bodies regulate local service rates, intrastate access rates and telecommunications company borrowing. The Federal Communications Commission ("FCC") regulates interstate access rates and the issuance of licenses required to operate certain types of telecom operations. Some member telecommunications systems have affiliated companies that are not regulated.

The Telecommunications Act of 1996 (the "Telecom Act") created a framework for competition and deregulation in the local telecommunications market. The Telecom Act had four basic goals: competition, universal service, deregulation and fostering advanced telecommunications and information technologies. To achieve competition, the Act required all carriers to interconnect with all others and LECs to provide competitors with access to elements of their networks. Congress included provisions in the Telecom Act granting RLECs an exemption from the above requirement to provide competitors with access to their networks, absent a determination that it would be in the public interest.

Competition continues to be a significant factor in the telecommunications industry. A January 2007 FCC report on competition states that as of June 2006, competitive local exchange carriers ("CLECs") provided service to 30 million access lines - 17.4 % of the nation's 172 million end-user switched access lines. Wireless carriers are providing service to 217.4 million mobile telephone service subscriptions - more than incumbent LEC ("ILECs") and CLECs combined. Non facilities-based CLECs took advantage of pro-competitive FCC rules that allowed CLECs to obtain all elements of the ILECs' networks necessary to conduct business at favorable rates. This is known as the unbundled network element platform ("UNE-P") and consisted of a combination of an unbundled loop, unbundled local circuit switching and shared transport.

A March 2004 court order forced the FCC to revisit its rules on UNE-P. In a decision favorable to the regional Bell companies, in December 2004, the FCC ruled that ILECs no longer had any obligation to provide CLECs with mass market local circuit switching and gave CLECs 12 months to transition existing customers off of unbundled local circuit switching. This ruling caused the UNE-P CLEC business model to collapse and created extreme hardship for many such CLECs. Over 50% of total CLEC lines as of June 2004 were provided through UNE-P. AT&T and MCI subsequently exited the residential CLEC market. Combined with the failure of the stand-alone long distance provider business model, AT&T and MCI sought merger partners. AT&T was merged into SBC and is now known as AT&T. MCI merged into Verizon.

RLECs generally were not subject to UNE-P based competition, since RLECs enjoyed an exemption contained in the Telecom Act; however, rural telecommunications companies are experiencing competition. For the most part, local exchange competition has benefited RLECs by enabling them to enter nearby towns and cities as competitive LECs, leveraging their existing infrastructure and reputation for providing quality, modern telecommunications service.

In addition to competition, the Telecom Act also mandated a universal telecommunications service support mechanism and required that it be: (1) sufficient to ensure that rural customers receive reasonably comparable rates and services when compared to urban customers; and (2) portable, that is available to all eligible providers. Congress stated its intent that implicit subsidies presently contained in the access charges local telecommunications companies levy on long distance carriers be eliminated and be made explicit in the new universal service support mechanism. Rules adopted by the FCC in 2000 have provided adequate levels of universal service support. This has been essential for RLECs, as other FCC rulings have reduced access charges which are a key revenue source. Numerous wireless carriers have entered rural markets as competitors to the RLECs. By obtaining competitive eligible telecommunications carrier status from state regulators (as provided for in the Telecom Act), these wireless carriers are able to receive universal service funds ("USF") based on the incumbent LEC's costs. This has led to growth of the fund and great concern for its sustainability. USF's current funding base of interstate telecommunications revenues is shrinking as long distance minutes-of-use go down due to wireless, email and voice over internet protocol substitution. Uncontrolled demand for USF funding has resulted in the rate assessed on all participants in the nationwide network becoming unsustainably high. The second quarter 2007 assessment rate is 11.7%. All industry segments agree that changes need to be made regarding eligibility and the funding mechanism for USF. However, they are not all in agreement on what those changes should be. The Federal-State Joint Board has recently recommended limiting payments to wireless carriers at the 2006 levels on an interim basis to help stabilize the fund until Congress and the FCC can develop a long-term solution. Wireline carriers support this approach. Wireless carriers are opposed.

The FCC also has a proceeding open on intercarrier compensation – the most important components of which are access fees LECs charge to interexchange carriers that originate or terminate long distance traffic on LEC networks. While the large LECs (most of which now own long distance companies) would like to see these fees transition to zero, RLECs depend heavily on access charges and are active participants in the FCC proceeding. RLECs have come together with a unified proposal that would preserve some access fees and are promoting it with the FCC.

While uncertainty exists regarding USF and access, the Company does not anticipate that any potential revenue losses resulting from these changes will result in material losses on loans outstanding to rural telecommunications companies.

Most RLECs are expanding their service offerings to customers. Without cable as a competitor in most rural areas, RLECs are introducing digital video, high-speed data, and local and long distance voice service. Where they can leverage their infrastructure, they are competing with Verizon, Qwest, AT&T, Embarq and cable companies in neighboring towns. RLECs have generally been very successful competitors in these situations.

Deregulation has not had much effect on LECs thus far. The FCC has promulgated a series of rules to implement the Telecom Act, and eliminated very few existing regulatory requirements. States continue to regulate RLECs extensively. A revised or totally rewritten Telecom Act would start a whole new round of regulatory proceedings.

Another aspect of the Telecom Act dealt with advanced telecommunications and information technologies. In the late 1990s there was the concern that there was a growing "digital divide" between various groups and areas within the country. Legislators sought to provide broadband connectivity to all Americans through programs which provide funding to connect schools and libraries to the internet. RUS has issued rules liberalizing its lending criteria to facilitate provision of advanced telecommunications and information services in rural areas. Congress also created an RUS broadband loan program in 2002. To date, RUS has made 70 broadband loans totaling $1.22 billion. Congress authorized $500 million in fiscal year 2007 lending authority. For fiscal year 2008, the Administration is proposing an additional $300 million.

Given the increased availability of government financing for rural broadband, it is unlikely that the Company will be participating in this financing to any significant degree outside of incremental lending to existing RLEC borrowers to provide broadband services to their customers.

The RUS Program

Since the enactment of the Rural Electrification Act in 1936 (the "RE Act"), RUS has financed the construction of electric generating plants, transmission facilities and distribution systems in order to provide electricity to rural areas. Principally through the organization of systems under the RUS loan program in 47 states and one U.S. territory, the percentage of farms and residences in rural areas of the United States receiving central station electric service increased from 11% in 1934 to almost 100% currently. Rural electric systems serve 12% of all consumers of electricity in the United States and its territories and account for approximately 10% of total sales of electricity and own about 5% of energy generation and generating capacity.

In 1949, the RE Act was amended to allow RUS to lend for the purpose of furnishing and improving rural telecommunications service. For fiscal year 2007, RUS has $690 million in lending authority for rural telephone systems and an additional $558 million for other telecommunications programs, including distance learning and broadband.

The RE Act provides for RUS to make insured loans and to provide other forms of financial assistance to electric borrowers. RUS is authorized to make direct loans, at below market rates, to systems that qualify for the hardship program (5% interest rate) or the municipal rate program (based on a municipal government obligation index). RUS is also authorized to guarantee loans that are used mainly to provide financing for construction of power supply projects. Guaranteed loans bear interest at a rate agreed upon by the borrower and the lender (which generally has been the Federal Financing Bank ("FFB")). RUS also provides financing at the Treasury rate. The RUS exercises financial and technical supervision over borrowers' operations. Its loans and guarantees are generally secured by a mortgage on substantially all of the system's property and revenues.

For the fiscal year ending September 30, 2008, the President's budget requests $100 million for hardship loans and $4 billion for loan guarantees with no requested budget for both municipal rate loans and treasury rate loans. Neither the House of Representatives or the Senate have passed an Appropriations measure settling the fiscal year 2008 RUS Electric loan program levels. Electric funding levels for fiscal year 2007 were as follows: municipal rate loans of $100 million, hardship loans of $99 million, treasury rate loans of $1 billion, and loan guarantees of $2.7 billion.

Item 1A. Risk Factors.

The Company's financial condition and results of operations are subject to various risks inherent in its business. The material risks and uncertainties that management believes affect CFC are described below. The risks and uncertainties described below are not the only ones facing CFC. Additional risks and uncertainties that management is not aware of, or that it currently deems immaterial, may also impair business operations. If any of the events or circumstances described in the following risks actually occur, our business, financial condition or results of operations could suffer. You should consider all of the following risks together with all of the other information in this Annual Report on Form 10-K.

The Company's ability to maintain and grow our business depends on access to external financing.
The Company depends on access to the capital markets to refinance its long-term and short-term debt, fund new loan advances and if necessary, to fulfill its obligations under its guarantee and repurchase agreements. At May 31, 2007, the Company had $2,884 million of commercial paper, daily liquidity fund and bank bid notes and $1,543 million of medium-term notes, collateral trust bonds, subordinated deferrable debt and long-term notes payable scheduled to mature during the next twelve months. There can be no assurance that the Company will be able to access the markets in the future at all or on terms that are acceptable to the Company. Downgrades to the Company's long-term debt ratings and/or commercial paper ratings or other events that may deny or limit the Company's access to the capital markets could negatively impact its operations. The Company has no control over certain items that are considered by the credit rating agencies as part of their analysis for the Company, such as the overall outlook for the electric and telecommunications industries.

Fluctuating interest rates could adversely affect our income, margin and cash flow.
The Company is exposed to interest rate risk in its core lending and borrowing activities. If the Company does not set interest rates on its loans at a level to cover its cost of funding, there would be an adverse affect on net interest income and net income.

The Company provides its members with many options on its loans with regard to interest rates, the term for which the selected interest rate is in effect and the ability to prepay the loan. As a result there is a possibility of significant changes in the composition of the loan portfolio. If the Company is not able to adjust its outstanding debt portfolio to match the changes in the loan portfolio, there could be an adverse impact on net interest income and net income.

In addition, the Company's calculated impairment on non-performing and restructured loans will increase as the Company's long-term variable and short-term interest rates increase. Currently, an increase of 25 basis points to the Company's variable interest rates would result in an increase of $7 million to the calculated impairment.

Competition from other lenders could impair the Company's financial results.
The majority of the Company's members are eligible to borrow from RUS. The rates offered by RUS are generally lower than the rates that the Company and other lenders can offer. Thus the members' first financing option generally is to borrow funds under the RUS program. The RUS funding level is determined by the U.S. Congress each year. Increases to the amount of RUS funding could limit the amount of loan growth experienced by the Company.

The Company competes with other lenders for the portion of the loan commitment that RUS will not lend, for the loans to members that cannot borrow from RUS or for loans to members that have elected not to borrow from RUS. If other lenders are more successful than the Company in the competition for this loan volume, it could have an adverse impact on the Company's financial results.

We may not recover the value of amounts that we lend.

CFC's allowance for loan losses is established through a provision charged to expense that represents management's best estimate of probable losses that have been incurred within the existing portfolio for loans. The level of the allowance reflects management's continuing evaluation of: industry concentrations; specific credit risks; loan loss experience; current loan portfolio quality; present economic, political and regulatory conditions and unidentified losses and risks inherent in the current loan portfolio. The determination of the appropriate level of the allowance for loan losses involves a high degree of subjectivity and requires CFC to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of CFC's control, may require an increase in the allowance for loan losses. In addition, if actual losses incurred exceed current estimates of probable losses currently included in the allowance for loan losses, CFC will need additional provisions to increase the allowance for loan losses. Any increases in the allowance for loan losses will result in a decrease in net income, and may have a material adverse effect on CFC's financial results and credit ratings.

The Company has been and may in the future be in litigation with borrowers related to enforcement or collection actions pursuant to loan documents. In such cases, the borrower or others may assert counterclaims against the Company or initiate actions against the Company related to the loan documents. Unfavorable rulings in these cases which result in loan losses that exceed the related allowance could have a material adverse effect on our financial results and credit ratings.

Our ability to access the capital markets depends on our ability to maintain adjusted leverage and debt to equity ratios within a reasonable range of the current levels.
Maintenance of adjusted leverage and debt to equity ratios within a reasonable range of the current levels is important in relation to the Company's ability to access the capital markets. A significant increase in the adjusted leverage or debt to equity ratios could impair the Company's ability to access the capital markets, its ability to access the Company's revolving lines of credit and its ability to maintain preferred credit ratings. See "Non-GAAP Financial Measures" for further explanation and a reconciliation of adjusted ratios.

A decline in our credit rating could trigger payments under our derivative agreements.
If the Company's credit rating falls to the level specified in certain of its derivative agreements, the other counterparty may terminate the agreement. If the counterparty terminates the agreement, a net payment may be due from one counterparty to the other based on the fair value of the underlying derivative instrument. Based on the fair market value of its interest rate exchange agreements subject to rating triggers at May 31, 2007, the Company may be required to make a payment of up to $5 million if its senior unsecured ratings declined to Baa1 or BBB+, and up to $47 million if its senior unsecured ratings declined below Baa1 or BBB+. In calculating the required payments, the Company only considered agreements in which it would have been required to make a payment upon termination. In the event the Company is required to make a payment as a result of a rating trigger, it could have a material adverse impact on its financial results.

Our ability to comply with covenants related to our revolving credit agreements and debt indentures may affect our ability to obtain financing and maintain preferred rating levels on our debt.
The Company must maintain compliance with all covenants related to its revolving credit agreements, including the adjusted TIER, adjusted leverage and amount of loans pledged in order to have access to the funds available under the revolving lines of credit. See "Non-GAAP Financial Measures" for further explanation and a reconciliation of adjusted ratios. A restriction on access to the revolving lines of credit would impair the Company's ability to issue short-term debt, as it is required to maintain backup-liquidity to maintain preferred rating levels on its short-term debt.

If the Company does not maintain compliance with covenants on its collateral trust bond, medium-term note and subordinated deferrable debt indentures, the holders of such debt could declare an event of default and accelerate the repayment of the full amount of the outstanding debt principal prior to the stated maturity of such debt. Additionally, the Company could not issue new debt under such indentures. Such an event would require the Company to obtain new funding to repay the accelerated debt as a result of the covenant default and could have a material adverse impact on its financial results and credit ratings.

Our concentration of loans to borrowers within rural electric and telephone industries could impair our revenues if either or both of those industries were to experience economic difficulties.
Credit concentration is one of the risk factors considered by the rating agencies in the evaluation of the Company's credit rating. Substantially all of the Company's credit exposure is to the rural electric and telephone industries and is subject to risks associated with those industries.

The Company's credit concentration to its ten largest borrowers could increase from the current 18% of total loans and guarantees outstanding, if:

- it were to extend additional loans and/or guarantees to the current ten largest borrowers,
-

its total loans and/or guarantees outstanding were to decrease, with a disproportionately large share of the decrease to borrowers not in the current ten largest, or

- it were to advance large new loans and/or guarantees to one of the borrowers below the ten largest.

We could jeopardize our federal tax exemption if we fail to conduct our business in accordance with our exemption from the Internal Revenue Service.
Legislation that removes or imposes new conditions on the federal tax exemption for 501(c)(4) social welfare organizations could have a negative impact on the Company's net income. CFC's continued exemption depends on it conducting its business in accordance with its 501(c)(4) status.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

CFC leases office space that serves as its headquarters in Fairfax County, Virginia. In October 2005, CFC entered into a three-year lease with the building owner for approximately 107,228 square feet of the facility's office, meeting and storage space. CFC has the option to extend the lease for two additional one-year periods with terms similar to the initial three-year lease.

Item 3. Legal Proceedings.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters.

Inapplicable.

Item 6. Selected Financial Data.

The following is a summary of selected financial data for the years ended May 31:

(Dollar amounts in thousands)	2007	2006 (As restated) (11)	2005 (As restated) (11)	2004 (As restated) (11)	2003 (As restated) (11)
For the year ended May 31:					
Interest income	$ 1,054,224	$ 1,007,912	$ 1,030,853	$ 1,009,856	$ 1,075,310
Net interest income	57,494	31,976	88,820	68,365	123,682
Derivative cash settlements (1)	86,442	80,883	78,287	123,363	130,686
Derivative forward value (1)	(79,281)	28,805	25,849	(228,840)	754,727
Foreign currency adjustments (2)	(14,554)	(22,594)	(22,893)	(65,310)	(243,220)
Income (loss) prior to income taxes, minority interest and cumulative effect of change in accounting principle (3)	16,541	105,762	126,561	(194,292)	649,485
Cumulative effect of change in accounting principle (4)	-	-	-	22,369	-
Net income (loss)	$ 11,701	$ 95,497	$ 122,503	$ (177,729)	$ 649,485
Fixed charge coverage ratio (TIER) (5)(6)	1.01	1.10	1.13	-	1.68
Adjusted fixed charge coverage ratio (Adjusted TIER) (7)	1.12	1.11	1.14	1.12	1.17
As of May 31:					
Loans to members	$18,128,207	$18,360,905	$18,972,068	$20,488,523	$19,484,341
Allowance for loan losses	(561,663)	(611,443)	(589,749)	(573,939)	(511,463)
Assets	18,575,181	19,179,621	20,060,314	21,455,443	21,139,282
Short-term debt (8)	4,427,123	5,343,824	7,952,579	5,990,039	5,046,978
Long-term debt (9)	11,295,219	10,642,028	8,701,955	12,009,182	12,050,119
	311,440	486,440	685,000	550,000	650,000

Subordinated deferrable debt (10)					
Members' subordinated certificates	1,381,447	1,427,960	1,490,750	1,665,158	1,708,297
Members' equity (1)	566,286	545,351	523,583	483,126	454,376
Total equity	710,041	784,408	764,934	692,453	927,453
Guarantees	$ 1,074,374	$ 1,078,980	$ 1,157,752	$ 1,331,299	$ 1,903,556
Leverage ratio (6)	26.64	24.80	26.71	31.88	23.85
Adjusted leverage ratio (7)	6.81	6.38	6.50	7.07	6.69
Debt to equity ratio (6)	25.13	23.42	25.20	29.95	21.79
Adjusted debt to equity ratio (7)	6.37	5.97	6.07	6.58	6.01

(1) Derivative cash settlements represent the net settlements received/paid on interest rate and cross currency exchange agreements that do not qualify for hedge accounting for the years ended May 31, 2007, 2006, 2005, 2004 and 2003. The derivative forward value represents the change in fair value on exchange agreements that do not qualify for hedge accounting, as well as amortization related to the long-term debt valuation allowance and related to the transition adjustment recorded as an other comprehensive loss on June 1, 2001. Members' equity represents total equity excluding foreign currency adjustments, derivative forward value and accumulated other comprehensive income (see "Non-GAAP Financial Measures" in Management's Discussion and Analysis for further explanation of members' equity and a reconciliation to total equity).

(2) Foreign currency adjustments represent the change on foreign denominated debt that is not related to a qualifying hedge under SFAS 133 during the period. The foreign denominated debt is revalued at each reporting date based on the current exchange rate. To the extent that the current exchange rate is different than the exchange rate at the time of issuance, there will be a change in the value of the foreign denominated debt. CFC enters into foreign currency exchange agreements at the time of each foreign denominated debt issuance to lock in the exchange rate for all principal and interest payments required through maturity.

(3) Includes $43 million gain on sale of building and land at May 31, 2006.

(4) The cumulative effect of change in accounting principle in 2004 represents the impact of implementing Financial Accounting Standards Board Interpretation No. 46 (R), Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51, effective June 1, 2003.

(5) The fixed charge coverage ratio is the same calculation as CFC's Times Interest Earned Ratio ("TIER"). For the year ended May 31, 2004, CFC's earnings were insufficient to cover fixed charges by $200 million.

(6) See "Non-GAAP Financial Measures" in Management's Discussion and Analysis for the GAAP calculations of these ratios.

(7) Adjusted ratios include non-GAAP adjustments that CFC makes to financial measures in assessing its financial performance. See "Non-GAAP Financial Measures" in Management's Discussion and Analysis for further explanation of these calculations and a reconciliation of the adjustments.

(8) Includes the foreign currency valuation account of $245 million, $40 million and $150 million at May 31, 2006, 2005 and 2003, respectively.

(9) Excludes $1,368 million, $1,839 million, $3,591 million, $2,365 million, and $ 2,911 million in long-term debt that comes due, matures and/or will be redeemed during fiscal years 2008, 2007, 2006, 2005 and 2004, respectively (see Note 5 to the consolidated financial statements). Includes the long-term debt valuation allowance of $(1) million and $2 million at May 31, 2003 and 2002, respectively, and the foreign currency valuation account of $221 million, $234 million and $176 million at May 31, 2005, 2004 and 2003, respectively.

(10) Excludes $175 million called in June 2007 and $150 million called in June 2006 at May 31, 2007 and 2006, respectively, reported in short-term debt.

(11)

See Note 1 (w) to the consolidated financial statements for further explanation of the restatement of the consolidated statement of operations data for fiscal years 2006 and 2005 and the consolidated balance sheet data as of May 31, 2006. Prior year periods have been revised to reflect the adjustments related to the restatement described in Note 1(w).

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Unless stated otherwise, references to the Company relate to the consolidation of National Rural Utilities Cooperative Finance Corporation ("CFC" or "the Company"), Rural Telephone Finance Cooperative ("RTFC"), National Cooperative Services Corporation ("NCSC") and certain entities controlled by CFC and created to hold foreclosed assets and effect loan securitization transactions. The following discussion and analysis is designed to provide a better understanding of the Company's consolidated financial condition and results of operations and as such should be read in conjunction with the consolidated financial statements, including the notes thereto. CFC refers to its financial measures that are not in accordance with generally accepted accounting principles ("GAAP") as "adjusted" throughout this document. See "Non-GAAP Financial Measures" for further explanation of why the Non-GAAP measures are useful and for a reconciliation to GAAP amounts.

Restatement

Subsequent to the issuance of the May 31, 2006 consolidated financial statements, the Company's management identified an error in the recording of interest expense on foreign denominated debt and the cash settlement income from foreign currency exchange agreements, as well as the related accrued interest payable and accrued interest receivable. The Company was using the agreed upon foreign exchange rate from the foreign currency exchange agreement rather than the average spot foreign currency exchange rate during the income statement period to convert the interest expense on the foreign denominated debt and foreign exchange agreement income to U.S. dollars. The Company was also using the agreed upon foreign exchange rate from the foreign currency exchange agreement rather than the spot foreign currency exchange rate at the end of the balance sheet period to convert the accrued interest payable and accrued interest receivable to U.S. dollars. The interest expense on the foreign denominated debt and the cash settlement income from the foreign currency exchange agreement are equal and offsetting amounts, as the Company uses the amount received under the exchange agreement to pay the interest expense on the foreign denominated debt. The amounts for the accrued interest payable and accrued interest receivable are also offsetting. As a result of this error, interest expense and cash settlement income were understated by $13 million and $15 million for the years ended May 31, 2006 and 2005, respectively. The Company subtracts the net accrual from the last settlement date on its derivatives at each period end in the calculation of the related fair value, so the error in the calculation of the income receivable on the foreign exchange agreements also impacted the fair value of the derivatives recorded as a derivative asset. Thus this correction also impacts the change in the fair value of the derivatives reported in the derivative forward value line on the consolidated statement of operations. The derivative forward value line and net income were overstated by $0.2 million and $0.5 million for the years ended May 31, 2006 and 2005, respectively. There is no impact on cash flows from operating activities or the total change in cash in the consolidated statements of cash flows. There was no change to the reported times interest earned ("TIER") calculation for either year. The amounts reported on the consolidated balance sheet for accrued interest payable and accrued interest and other receivables at May 31, 2006 were understated by $4 million and the amounts reported for the derivative asset and retained equity at May 31, 2006 were overstated by $4 million.

The Company has revised the Management's Discussion and Analysis for the effects of this restatement.

Business Overview

CFC was formed in 1969 by rural electric cooperatives to provide a source of financing to supplement the loan programs of the Rural Utilities Service ("RUS"). CFC is organized as a cooperative in which each member (other than associates) is entitled to one vote. Under CFC's bylaws, the board of directors is composed of 23 individuals, 20 of whom must be either general managers or directors of member systems, two of whom are designated by the National Rural Electric Cooperative Association and one at-large position who must satisfy the requirements of an audit committee financial expert as defined by Section 407 of the Sarbanes-Oxley Act of 2002 and must be a trustee, director, manager, Chief Executive Officer or Chief Financial Officer of a member. In November 2006, the CFC Board elected an at-large director that qualifies as a financial expert who will serve on the audit committee. The director took his seat on the board following the CFC annual meeting in March 2007. CFC is a tax-exempt entity under Section 501(c)(4) of the Internal Revenue Code.

RTFC is a not-for-profit private cooperative association created for the purpose of providing and/or arranging financing for its rural telecommunications members and their affiliates. NCSC also is a private non-profit cooperative association. The principal purpose of NCSC is to provide financing to the for-profit or non-profit entities that are owned, operated or controlled by or provide substantial benefit to, members of CFC.

The Company's primary objective as a cooperative is to provide its members with low loan and guarantee rates while maintaining sound financial results required to attain high credit ratings on its debt instruments. As a not-for-profit, membership owned financial institution, the Company's goal is not to maximize its profit on loans to members, but rather to find a balance between charging its members low rates on loans and maintaining the financial performance required to access the capital markets on behalf of its members. Thus, the Company marks up its funding costs only to the extent necessary to cover its operating expenses, a provision for loan losses and to provide earnings sufficient to preserve interest coverage in light of the Company's financing objectives.

At May 31, 2007, the Company's consolidated membership was 1,544 including 899 utility members, the majority of which are consumer-owned electric cooperatives, 513 telecommunications members, 66 service members and 66 associates in 49 states, the District of Columbia and two U.S. territories. The utility members included 830 distribution systems and 69 generation and transmission ("power supply") systems.

CFC obtains its funding from the capital markets, private placement of debt and its membership. CFC enters the capital markets, based on the combined strength of its members, to borrow the funds required to fulfill the financing requirements of its members. On a regular basis, CFC obtains debt financing in the capital markets by issuing fixed rate or variable rate secured collateral trust bonds, fixed rate subordinated deferrable debt, fixed rate or variable rate unsecured medium-term notes, commercial paper and enters into bank bid note agreements. In addition, CFC obtains debt financing from private funding sources through the issuance of fixed rate notes. CFC also obtains debt financing from its membership and other qualified investors through the direct sale of its commercial paper, daily liquidity fund and unsecured medium-term notes.

Rural electric cooperatives that join CFC are generally required to purchase membership subordinated certificates from CFC as a condition of membership. In connection with any long-term loan or guarantee made by CFC on behalf of one of its members, CFC may require that the member make an additional investment in CFC by purchasing loan or guarantee subordinated certificates. The membership subordinated certificates and the loan and guarantee subordinated certificates are unsecured and subordinate to other senior debt of CFC.

CFC is required by law to have a mechanism to allocate its net income to its members. CFC allocates its net income excluding the non-cash effects of Statement of Financial Accounting Standards ("SFAS") 133, Accounting for Derivative Instruments and Hedging Activities, as amended and SFAS 52, Foreign Currency Translation annually to an education fund, a members' capital reserve and to members based on each member's patronage of the loan programs during the year. RTFC annually allocates its net income to its members based on each member's patronage of the loan programs during the year. NCSC does not allocate its net income to its members.

The Company's performance is closely tied to the performance of its member rural electric and telecommunications systems due to the near 100% concentration of its loan and guarantee portfolio in those industries.

Financial Overview

Results of Operations

The Company uses TIER instead of the dollar amount of net interest income or net income as its primary performance indicator, since its net income in dollar terms is subject to fluctuation as interest rates change. TIER is a measure of the Company's ability to cover the interest expense on its debt obligations. TIER is calculated by dividing the sum of interest expense and the net income prior to the cumulative effect of change in accounting principle by the interest expense.

For the year ended May 31, 2007, the Company reported net income of $12 million and TIER of 1.01, compared to a net income of $96 million and TIER of 1.10 for the prior year. For the year ended May 31, 2007, the Company reported an adjusted net income of $108 million and adjusted TIER of 1.12, compared to an adjusted net income of $97 million and adjusted TIER of 1.11 for the prior year. See "Non-GAAP Financial Measures" for more information on the adjustments the Company makes to its financial results for the purposes of its own analysis and covenant compliance.

During the year ended May 31, 2007, the Company's earnings were impacted by the level of loans on non-accrual status. Holding loans on non-accrual status resulted in a reduction of $81 million to reported interest income for the year ended May 31, 2007. During fiscal year 2008, the Company expects the outstanding balance on the current loans on non-accrual status to decrease due to anticipated loan write-offs and principal repayments. The Company anticipates writing off approximately $17 million related to VarTec Telecom, Inc. (“VarTec”) during the first quarter of fiscal year 2008. This write-off will reduce the exposure to the amount of the expected recovery on the debtor-in-possession loan. In addition, it is expected that Denton County Electric Cooperative, Inc. d/b/a CoServ Electric (“CoServ”) will make scheduled quarterly payments totaling $25 million, which will all be applied as a reduction to principal in fiscal year 2008.

The reduction to the amount of loans on non-accrual status should result in an increase to the adjusted net interest income yield during fiscal year 2008. Changes to the Company's variable interest rates should mirror changes to the federal funds rate. The calculated impairment on the Company's loans increases or decreases with the increases and decreases to the Company's variable interest rates. Based on the current balance of impaired loans at May 31, 2007, an increase or decrease of 25 basis points to the Company's variable interest rates results in an increase or decrease of approximately $7 million, respectively, to the calculated impairment on loans irrespective of a change in the credit fundamentals of the impaired borrower.

Financial Condition

During the year ended May 31, 2007, the Company's total loans outstanding decreased by $233 million or 1% from May 31, 2006. At May 31, 2007, RTFC loans outstanding decreased by $302 million, CFC loans outstanding increased by $10 million and NCSC loans outstanding increased by $59 million compared to May 31, 2006. CFC loan advances were offset by the sale of $366 million of CFC distribution loans at par in a loan securitization transaction in February 2007. CFC expects to continue such loan sales. See further discussion in “Results of Operations”.

The Company expects that the balance of the loan portfolio will remain relatively stable during fiscal year 2008. Loans from the Federal Financing Bank ("FFB"), a division of the U.S. Treasury Department, with an RUS guarantee, represent a lower cost option for rural electric utilities compared to the Company. The Company anticipates that the majority of its electric loan growth will come from distribution system borrowers that have fully prepaid their RUS loans and choose not to return to the government loan program, from distribution system borrowers that do not want to wait the 12 to 24 months it may take RUS to process and fund the loan and from power supply systems. The Company anticipates that the RTFC loan balance will continue to decline due to long-term loan amortization and lower levels of capital expenditure requirements and asset acquisitions in the rural telecommunications marketplace.

During the year ended May 31, 2007, short-term debt decreased by $917 million and long-term debt increased by $653 million. Short-term debt decreased due to the maturity of medium-term notes and because CFC further reduced its reliance on the dealer commercial paper markets.

At May 31, 2007, the Company reported total equity of $710 million, a decrease of $74 million from $784 million reported at May 31, 2006. Under GAAP, the Company's reported equity balance fluctuates based on the impact of future expected changes to interest rates on the fair value of its interest rate exchange agreements. As a result, it is difficult to predict the future changes in the Company's reported GAAP equity due to the uncertainty of the movement in future interest rates. In its internal analysis and for purposes of covenant compliance under its credit agreements, the Company adjusts equity to exclude the non-cash impacts of SFAS 133 and 52.

Liquidity

At May 31, 2007, the Company had $2,884 million of commercial paper, daily liquidity fund and bank bid notes and $1,543 million of medium-term notes, collateral trust bonds, subordinated deferrable debt and long-term notes payable scheduled to mature during the next twelve months. Members held commercial paper (including the daily liquidity fund) totaling $1,634 million or approximately 59% of the total commercial paper outstanding at May 31, 2007. Commercial paper issued through dealers and bank bid notes totaled $1,118 million and represented 6% of total debt outstanding at May 31, 2007. The Company intends to maintain the balance of dealer commercial paper and bank bid notes at 15% or less of total debt outstanding during fiscal year 2008. During the next twelve months, the Company plans to refinance the $1,543 million of medium-term notes, collateral trust bonds, subordinated deferrable debt and long-term notes payable and fund new loan growth by issuing a combination of commercial paper, medium-term notes, collateral trust bonds and other debt.

CFC uses member loan repayments, capital market debt issuance, private debt issuance, member investments, and net income to fund its operations. In addition, the Company maintains both short-term and long-term bank lines in the form of revolving credit agreements with its bank group. Members pay a small membership fee and are typically required to purchase subordinated certificates as a condition to receiving a long-term loan advance and as a condition of membership. CFC has a need for funding to make loan advances to its members, to make interest payments on its public and private debt and to make payments of principal on its maturing debt. To facilitate open access to the capital markets, CFC is a regular issuer of debt in the capital markets, maintains strong credit ratings and has shelf registrations on file with the Securities and Exchange Commission ("SEC"). The Company plans to file a registration statement as a well-known seasoned issuer that will authorize the Company to issue an unlimited amount of debt under each of its public debt instruments for a three-year period. CFC also has access to foreign debt markets with Euro medium-term note and commercial paper programs and an Australian medium-term note program.

The Company can borrow amounts from the FFB with a guarantee of repayment by the RUS as part of the funding mechanism for the Rural Economic Development Loan and Grant ("REDLG") program. As a result of the RUS guarantee, these funds may represent a lower cost compared to the Company's other forms of debt securities. Subsequent to our fiscal year-end, on August 1, 2007, CFC submitted an application to borrow the remaining $500 million available under FFB loan facilities. These funds were received by CFC on August 7, 2007.

Subsequent to our fiscal year-end, on June 1, 2007, the Company redeemed the 7.40% subordinated deferrable debt securities due 2050 totaling $175 million. The Company redeemed these securities at par and recorded a charge of $6 million in interest expense during the first quarter of fiscal year 2008 for the unamortized issuance costs.

Critical Accounting Estimates

Allowance for Loan Losses

At May 31, 2007 and 2006, the Company had a loan loss allowance that totaled $562 million and $611 million, representing 3.10% and 3.33% of total loans outstanding, respectively. GAAP requires loans receivable to be reported on the consolidated balance sheets at net realizable value. The net realizable value is the total principal amount of loans outstanding less an estimate of the probable losses inherent in the portfolio. The Company calculates its loss allowance on a quarterly basis. The loan loss allowance is calculated by segmenting the portfolio into three categories of loans: impaired, high risk and general portfolio. There are significant subjective assumptions and estimates used in calculating the amount of the loss allowance required by each of the three categories. Different assumptions and estimates could also be reasonable. Changes in these assumptions and estimates could have a material impact on the Company's financial statements.

Impaired Exposure

The Company calculates impairment on certain loans in accordance with SFAS 114, Accounting by Creditors for Impairment of a Loan - an Amendment of SFAS 5 and SFAS 15, as amended. SFAS 114 states that a loan is impaired when a creditor does not expect to collect all principal and interest due under the original terms of the loan. The Company reviews its portfolio to identify impairments at least on a quarterly basis. Factors considered in determining an impairment include, but are not limited to: the review of the borrower's audited financial statements and interim financial statements if available, the borrower's payment history, communication with the borrower, economic conditions in the borrower's service territory, pending legal action involving the borrower, restructure agreements between the borrower and the Company, and estimates of the value of the borrower's assets that have been pledged as collateral to secure the Company's loans. The Company calculates the impairment by comparing the future estimated cash flow, discounted at the original loan interest rate, against its current investment in the receivable. If the current investment in the receivable is greater than the net present value of the future payments discounted at the original contractual interest rate, the impairment is equal to that difference. If it is not possible to estimate the future cash flow associated with a loan, then the impairment calculation is based on the value of the collateral pledged as security for the loan. At May 31, 2007 and 2006, the Company had a total of $397 million and $447 million reserved specifically against impaired exposure totaling $1,099 million and $1,201 million, respectively, representing 36% and 37%, respectively, of the total impaired loan exposure. The $397 million and $447 million specific reserves represented 71% and 73% of the total loan loss allowance at May 31, 2007 and 2006, respectively. The calculated impairment at May 31, 2007 was lower than at May 31, 2006 due to a settlement agreement with one borrower resulting in a loan write-off of $44 million and payments received on impaired loans offset by higher interest rates on variable rate loans. See further discussion under “Financial Condition”. The original contract rate on a portion of the impaired loans at May 31, 2007 will vary with the changes in the Company's variable interest rates. Based on the current balance of impaired loans at May 31, 2007, a 25 basis point increase or decrease to the Company's variable interest rates would result in an increase or decrease, respectively, of approximately $7 million to the calculated impairment irrespective of a change in the credit fundamentals of the impaired borrower.

In calculating the impairment on a loan, the estimates of the expected future cash flow or collateral value are the key estimates made by management. Changes in the estimated future cash flow or collateral value would impact the amount of the calculated impairment. The change in cash flow required to make the change in the calculated impairment material will be different for each borrower and depend on the period covered, the original contract interest rate and the amount of the loan outstanding. Estimates are not used to determine the Company's investment in the receivables or the discount rate since, in all cases, they are the loan balance outstanding at the reporting date and the original loan interest rate.

High Risk Exposure

Loan exposures considered to be high risk represent exposure in which the borrower has had a history of late payments, the borrower's financial results do not satisfy loan financial covenants, the borrower has contacted the Company to discuss pending financial difficulties or for some other reason, the Company believes that the borrower's financial results could deteriorate resulting in an elevated potential for loss. The Company's corporate credit committee is responsible for determining which loans should be classified as high risk and the level of reserve required for each borrower. The committee meets at least quarterly to review all loan facilities with an internal risk rating above a certain level. Once it is determined that exposure to a borrower should be classified as high risk, the committee sets the required reserve level based on the facts and circumstances for each borrower, such as the borrower's financial condition, payment history, the Company's estimate of the collateral value, pending litigation, if any, and other factors. This is an objective and subjective exercise in which the committee uses the available information to make its best estimate as to the level of loss allowance required. At any reporting date, the reserve required could vary significantly depending on the facts and circumstances, which could include, but are not limited to: changes in collateral value, deterioration in financial condition, the borrower declaring bankruptcy, payment default on the Company's loans and other factors. The borrowers in the high risk category will generally either move to the impaired category or back to the general portfolio within a period of 12 to 24 months. At May 31, 2007 and 2006, the Company had reserved $3 million and $2 million against the $6 million and $12 million of exposure classified as high risk, representing coverage of 50% and 17%, respectively. The $3 million and $2 million reserved for loans in the high risk category represented less than 1% of the total loan loss allowance at May 31, 2007 and 2006.

General Portfolio
The Company's methodology used to determine the required loan loss allowance for the general portfolio includes the use of an internal risk rating system, historical default data on corporate bonds and Company specific loss recovery data. The Company uses the following factors, in no particular order, to determine the level of the loan loss allowance for the general portfolio category:

- Internal risk ratings - the Company maintains risk ratings for each credit facility outstanding to its borrowers. The ratings are updated at least annually and are based on the following:
  - General financial condition of the borrower.
  - The Company's internal estimated value of the collateral securing its loans.
  - The Company's internal evaluation of the borrower's management.
  - The Company's internal evaluation of the borrower's competitive position within its service territory.
  - The Company's estimate of potential impact of proposed regulation and litigation.
  - Other factors specific to individual borrowers or classes of borrowers.
- Standard corporate default table - The table provides expected default rates based on rating level and the remaining maturity of the bond. The Company uses the standard default table for all corporate bonds published by Standard and Poor's Corporation to assist in estimating its reserve levels.
- Recovery rates - Estimated recovery rates based on historical experience of loan balance at the time of default compared to the total loss on the loan to date.

The Company aggregates the loans in the general portfolio by borrower type (distribution, generation, telecommunications, associate and other member) and by internal risk rating within borrower type. The Company correlates its internal risk ratings to the ratings used in the standard default table based on a comparison of its rating on borrowers that have a rating from one or more of the recognized credit rating agencies and based on a standard matching used by banks.

In addition to the general portfolio reserve requirement as calculated above, the Company maintains an additional reserve for borrowers with a total exposure in excess of 1.5% of its total loans and guarantees outstanding. The additional reserve is based on the amount of exposure in excess of 1.5% of the Company's total exposure and the borrower's internal risk rating. At May 31, 2007 and 2006, the Company had a reserve of $3 million based on the additional risk related to large exposures.

At May 31, 2007 and 2006, the Company had a total of $16,768 million and $16,886 million of loans, respectively, in the general portfolio. This total does not include $256 million and $261 million of loans at May 31, 2007 and 2006, respectively, that have a U.S. Government guarantee of all principal and interest payments. The Company does not maintain a loan loss allowance on loans that are guaranteed by the U.S. Government. At May 31, 2007 and 2006, the Company reserved a total of $162 million (including the $3 million described above for additional risk related to large exposures) for loans in the general portfolio representing coverage of 0.97% and 0.96%, respectively, of the total loans for the general portfolio.

In fiscal years 2007, 2006 and 2005, CFC recorded a recovery to the loan loss reserve totaling $7 million, provision of $23 million and provision of $16 million, respectively.

Senior management reviews the estimates and assumptions used in the calculations of the loan loss allowance for impaired loans, high risk loans and loans covered by the general portfolio, including large exposures related to single obligors, on a quarterly basis. Senior management discusses estimates with the board of directors and audit committee and reviews all loan loss related disclosures included in the Company's Form 10-Qs and Form 10-Ks filed with the SEC.

Management makes recommendations regarding loans to be written off to the CFC board of directors. In making its recommendation to write off all or a portion of a loan balance, management considers various factors including cash flow analysis and collateral securing the borrower's loans.

Derivative Financial Instruments

In June 1998, the FASB issued SFAS 133. SFAS 133, as amended, establishes accounting and reporting standards requiring that derivative instruments (including certain derivative instruments embedded in other contracts) be recorded in the consolidated balance sheets as either an asset or liability measured at fair value. The statement requires that changes in the derivative instrument's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative instrument's gains and losses to offset related results on the hedged item in the consolidated statements of operations or to be recorded as other comprehensive income, to the extent effective, and requires that a company formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. The Company is neither a dealer nor trader in derivative financial instruments. The Company uses interest rate, cross currency and cross currency interest rate exchange agreements to manage its interest rate and foreign currency risk.

Generally, the Company's derivatives do not qualify for hedge accounting. To qualify for hedge accounting, there must be a high correlation between the pay leg of the interest rate exchange agreement and the asset being hedged or between the receive leg of the interest rate exchange agreement and the liability being hedged. A large portion of the Company's interest rate exchange agreements use a 30-day composite commercial paper index as the receive leg, which would have to be highly correlated to the Company's own commercial paper rates to qualify for hedge accounting. The Company sells commercial paper to its members as well as to investors in the capital markets. The Company sets its commercial paper rates daily based on its cash requirements. The correlation between the Company's commercial paper rates and the 30-day composite commercial paper index has not been consistently high enough to qualify for hedge accounting. At May 31, 2007 and 2006, the Company did not have any interest rate exchange agreements that were accounted for using hedge accounting.

The Company does not plan to adjust its practice of using the 30-day composite commercial paper or a LIBOR index as the receive portion of its interest rate exchange agreements. The Company sets the variable interest rates on its loans based on the cost of its short-term debt, which is comprised of long-term debt due within one year and commercial paper. The Company believes that it is economically hedging its net interest income on loans by using the 30-day composite commercial paper or LIBOR index, which are the rates that are most closely related to the rates it pays on its own commercial paper. During certain periods, the correlation between the LIBOR rates or the 30-day composite commercial paper rate and the Company's 90-day and 30-day commercial paper rate has been higher than the required 90% to qualify for hedge accounting. However, the correlation is not consistently above the 90% threshold, therefore the interest rate exchange agreements that use the three-month LIBOR rate or 30-day composite commercial paper rate do not qualify for hedge accounting. For the purposes of its own analysis, the Company believes that the correlation is sufficiently high to consider these agreements effective economic hedges.

As a result of applying SFAS 133, the Company has recorded derivative assets of $223 million and $576 million and derivative liabilities of $72 million and $85 million at May 31, 2007 and 2006, respectively. From inception to date, accumulated other comprehensive income related to derivatives was $12 million and $13 million as of May 31, 2007 and 2006, respectively.

The impact of derivatives on the Company's consolidated statements of operations for the years ended May 31, 2007, 2006 and 2005 was a gain of $7 million, $107 million and $98 million, respectively. For the year ended May 31, 2007, the derivative forward value includes a charge of $31 million related to the termination of two interest rate exchange agreements. This amount was offset by a $31 million payment received as a result of the early termination and recorded as income in cash settlements. The change in the fair value of derivatives for the years ended May 31, 2007, 2006 and 2005 was a loss of $79 million, a gain of $29 million and a gain of $26 million, respectively, recorded in the Company's derivative forward value. For the years ended May 31, 2007, 2006 and 2005, the derivative forward value includes $0.8 million, $0.4 million and $16 million, respectively, related to the transition adjustment recorded as an other comprehensive loss on June 1, 2001, the date the Company implemented SFAS 133. In addition, income totaling $86 million, $79 million and $72 million was recorded for total net cash settlements received by the Company during the years ended May 31, 2007, 2006 and 2005, respectively, of which $86 million, $81 million and $78 million, respectively, relate to interest rate and cross currency interest rate exchange agreements that do not qualify for hedge accounting under SFAS 133 and were recorded in derivative cash settlements. The remaining expense of $2 million and $6 million for the years ended May 31, 2006 and 2005, respectively, relate to interest rate and cross currency interest rate exchange agreements that qualify for hedge accounting under SFAS 133 and were recorded in interest expense.

The Company is required to determine the fair value of its derivative instruments. Because there is not an active secondary market for the types of derivative instruments it uses, the Company obtains market quotes from its dealer counterparties. The market quotes are based on the expected future cash flow and estimated yield curves. The Company performs its own analysis to confirm the values obtained from the counterparties. The Company records the change in the fair value of its derivatives for each reporting period in the derivative forward value line on the consolidated statements of operations for the majority of its derivatives or in the other comprehensive income account on the consolidated balance sheets for the derivatives that qualify for hedge accounting. The counterparties are estimating future interest rates as part of the quotes they provide to the Company. The Company adjusts all derivatives to fair value on a quarterly basis. The fair value recorded by the Company will change as estimates of future interest rates change. To estimate the impact of changes to interest rates on the forward value of derivatives, the Company would need to estimate all changes to interest rates through the maturity of its outstanding derivatives. The Company has derivatives in the current portfolio that do not mature until 2045. In addition, the Company excludes the changes to the fair value of derivatives from its internal analysis since they represent the net present value of all future estimated cash settlements. Thus, the Company does not estimate the impact of changes in future interest rates to the fair value of its derivatives. The Company does not believe that volatility in the derivative forward value line on the consolidated statements of operations is material as it represents an estimated future value and not a cash impact for the current period.

Cash settlements that the Company pays and receives for derivative instruments that do not qualify for hedge accounting are recorded in the cash settlements line in the consolidated statements of operations. Each 25 basis point increase or decrease to the 30-day composite commercial paper index, the three-month LIBOR rate and the six-month LIBOR rate would result in a $5 million increase or decrease in the Company's total cash settlements due to the composition of the portfolio at May 31, 2007. The Company's interest rate exchange agreements at May 31, 2007 include $7,277 million notional amount, or 58% of the total interest rate exchange agreements in which the Company pays a fixed interest rate and receives a variable interest rate. For the remaining $5,256 million notional amount, or 42% of the total interest rate exchange agreements at May 31, 2007, the Company pays a variable interest rate and receives a fixed interest rate. Based on the interest rate exchange agreements in place at May 31, 2007, an increase to variable interest rates results in an increase to cash settlements due to CFC.

New Accounting Pronouncements

In February 2006, the FASB issued SFAS 155, Accounting for Certain Hybrid Financial Instruments – an amendment of SFAS 133 and 140. SFAS 155 permits fair value measurement of any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. SFAS 155 also clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133. It establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. SFAS 155 also clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives. SFAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company's adoption of SFAS 155 as of June 1, 2007 is not expected to have a material impact on the Company's financial position or results of operations.

In March 2006, the FASB issued SFAS 156, Accounting for Servicing of Financial Assets. SFAS 156 requires the initial measurement of all separately recognized servicing assets and liabilities at fair value and permits, but does not require, the subsequent measurement of servicing assets and liabilities at fair value. SFAS 156 is effective as of the beginning of the first fiscal year that begins after September 15, 2006. The Company's adoption of SFAS 156 as of June 1, 2007 is not expected to have a material impact on the Company's financial position or results of operations.

In June 2006, the FASB issued FIN No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109. FIN 48 clarifies the accounting for income taxes by prescribing a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company's adoption of FIN 48 as of June 1, 2007 is not expected to have a material impact on the Company's financial position or results of operations.

In September 2006, the FASB issued SFAS 157, Fair Value Measurements. SFAS 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS 157 is effective as of the beginning of the first fiscal year that begins after November 15, 2007. The Company's adoption of SFAS 157 as of June 1, 2008 is not expected to have a material impact on the Company's financial position or results of operations.

In February 2007, the FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities. The fair value option established by SFAS 159 permits entities to choose to measure eligible financial instruments at fair value. The unrealized gains and losses on items for which the fair value option has been elected should be reported in earnings. The decision to elect the fair value option is determined on an instrument by instrument basis and is irrevocable. Assets and liabilities measured at fair value pursuant to the fair value option should be reported separately in the balance sheet from those instruments measured using other measurement attributes. SFAS 159 is effective as of the beginning of the first fiscal year that begins after November 15, 2007. As part of the Company's adoption of SFAS 159 as of June 1, 2008, it does not plan to choose the option to measure eligible financial instruments at fair value and therefore the adoption of SFAS 159 is not expected to have a material impact on the Company's financial position or results of operations.

Results of Operations

Fiscal Year 2007 versus 2006 Results
The following chart presents the results for the year ended May 31, 2007 versus May 31, 2006.

	For the year ended May 31,		Increase/
(Dollar amounts in millions)	2007	2006	(Decrease)
Interest income	$1,054	$1,008	$ 46
Interest expense	(997)	(976)	(21)
Net interest income	57	32	25
Recovery of (provision for) loan losses	7	(23)	30
Net interest income after recovery of (provision for) loan losses	64	9	55
Non-interest income:			
Rental and other income	2	2	-
Derivative cash settlements	86	81	5
Results of operations of foreclosed assets	10	16	(6)
Gain on sale of building and land	-	43	(43)
Total non-interest income	98	142	(44)
Non-interest expense:			
Salaries and employee benefits	(34)	(31)	(3)
Other general and administrative expenses	(18)	(21)	3
Recovery of guarantee liability	2	1	1
Derivative forward value	(79)	29	(108)
Foreign currency adjustments	(15)	(23)	8
Loss on sale of loans	(2)	-	(2)
Total non-interest expense	(146)	(45)	(101)
Income prior to income taxes and minority interest	16	106	(90)
Income taxes	(2)	(3)	1
Minority interest, net of income taxes	(2)	(7)	5
Net income	$ 12	$ 96	$ (84)
TIER	1.01	1.10	
Adjusted TIER (1)	1.12	1.11	

(1) Adjusted to exclude the impact of the derivative forward value, foreign currency adjustments and minority interest from net income and to include all derivative cash settlements in the interest expense. See "Non-GAAP Financial Measures" for further explanation and a reconciliation of these adjustments.

CFC's net interest income will increase or decrease due to changes in loan volume and the rate that it receives on its loans and pays on its sources of funding, respectively. CFC's loan volume substantially determines its funding needs. The following Volume Rate Variance Table provides a breakout of the change to interest income, interest expense and net interest income due to changes in loan volume versus changes to interest rates. The analysis is consistent with the May 31, 2007 and 2006 consolidated statements of operations. For comparability purposes, average daily loan volume is used as the denominator in calculating interest income yield, interest expense rates and net interest income spread.

Management calculates an adjusted net interest income, which includes all derivative cash settlements in interest expense. The following table also includes a breakout of the change to derivative cash settlements due to changes in the average notional amount of its derivative portfolio versus changes to the net difference between the average rate paid and the average rate received. See "Non-GAAP Financial Measures" for further explanation of the adjustment the Company makes in its financial analysis to include all derivative cash settlements in its interest expense.

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Volume Rate Variance Table
(Dollar amounts in millions)

	For the year ended May 31,						Change due to		
	2007			2006					
	Average Loan Balance	Income/ (Cost)	Rate	Average Loan Balance	Income/ (Cost)	Rate	Volume (1)	Rate (2)	Total
Interest income									
CFC	$15,803	$ 917	5.80%	$15,605	$ 847	5.43%	$ 11	$ 59	$ 70
RTFC	1,994	106	5.30%	2,356	130	5.50%	(20)	(4)	(24)
NCSC	396	31	8.00%	444	31	7.08%	(4)	4	-
Total	$18,193	$1,054	5.79%	$18,405	$1,008	5.48%	$(13)	$ 59	$ 46
Interest expense									
CFC	$15,803	$ (870)	(5.51)%	$15,605	$ (827)	(5.30)%	$(10)	$(33)	$(43)
RTFC	1,994	(100)	(4.98)%	2,356	(123)	(5.21)%	18	5	23
NCSC	396	(27)	(6.90)%	444	(26)	(5.92)%	3	(4)	(1)
Total	$18,193	$ (997)	(5.48)%	$18,405	$ (976)	(5.30)%	$ 11	$(32)	$(21)
Net interest income									
CFC	$15,803	$ 47	0.29%	$15,605	$ 20	0.13%	$ 1	$ 26	$ 27
RTFC	1,994	6	0.32%	2,356	7	0.29%	(2)	1	(1)
NCSC	396	4	1.10%	444	5	1.16%	(1)	-	(1)
Total	$18,193	$ 57	0.31%	$18,405	$ 32	0.18%	$ (2)	$ 27	$ 25
Derivative cash settlements (3)									
CFC	$12,508	$ 86	0.69%	$15,030	$ 82	0.54%	$(14)	$ 18	$ 4
NCSC	124	1	0.33%	110	(1)	(0.84)%	-	2	2
Total	$12,632	$ 87	0.68%	$15,140	$ 81	0.53%	$(14)	$ 20	$ 6
Adjusted interest expense (4)									
Total	$18,193	$ (910)	(5.00)%	$18,405	$ (895)	(4.86)%	$ (3)	$(12)	$(15)

(1) Variance due to volume is calculated using the following formula: ((current average balance – prior year average balance) x prior year rate).
(2) Variance due to rate is calculated using the following formula: ((current rate – prior year rate) x current average balance).
(3) For derivative cash settlements, average loan balance represents the average notional amount of derivative contracts outstanding and the rate represents the net difference between the average rate paid and the average rate received for cash settlements during the period.
(4) See "Non-GAAP Financial Measures" for further explanation of the adjustment the Company makes in its financial analysis to include all derivative cash settlements in its interest expense.

Interest Income
Total interest income reported on the consolidated statements of operations and shown in the chart above includes the following and the weighted average interest rate thereon:

For the year ended May 31,
2007 2006

(Dollar amounts in millions)	Amount	Rate	Amount	Rate	Increase/ (Decrease)
Interest on long-term fixed rate loans (1)	$ 833		$ 759		$ 74
Interest on long-term variable rate loans (1)	115		154		(39)
Interest on short-term loans (1)	73		58		15
Total interest income on loans	1,021	5.61 %	971	5.28%	50
Interest on investments (2)	9	0.05 %	10	0.05%	(1)
Conversion fees (3)	9	0.05 %	14	0.08%	(5)
Make-whole and prepayment fees (4)	5	0.03 %	5	0.03%	-
Commitment and guarantee fees (5)	9	0.05 %	7	0.04%	2
Other fees	1	-	1	-	-
Total interest income	$ 1,054	5.79 %	$ 1,008	5.48%	$ 46

(1) Represents interest income on loans to members.
(2) Represents interest income on the investment of excess cash.
(3) Conversion fees are deferred and recognized using the interest method over the remaining original loan interest rate pricing term, except for a small portion of the total fee charged to cover administrative costs related to the conversion, which is recognized immediately.
(4) Make-whole and prepayment fees are charged for the early repayment of principal in full and recognized when collected.
(5) Commitment fees for RTFC loan commitments are, in most cases, refundable on a prorata basis according to the amount of the loan commitment that is advanced. Such refundable fees are deferred and then recognized on a prorata basis based on the portion of the loan that is not advanced prior to the expiration of the commitment. Commitment fees on CFC loan commitments are not refundable and are billed and recognized based on the unused portion of committed lines of credit. Guarantee fees are charged based on the amount, type and term of the guarantee. Guarantee fees are deferred and amortized using the straight-line method into interest income over the life of the guarantee.

The $46 million or 5% increase to the total interest income for the year ended May 31, 2007 as compared to the prior year period was due to the increase to CFC loan interest rates in the markets offset by lower loan volume. During the year ended May 31, 2007, the Company raised variable interest rates by approximately 15 basis points, while fixed interest rates remained relatively stable. For the year ended May 31, 2007, the Company had a reduction to interest income of $81 million due to non-accrual loans compared to a reduction of $79 million for the prior year period. The decrease in loan volume is due to the prepayment of RTFC loans during the year ended May 31, 2007. The $4 million decrease in fee and investment income earned during the year ended May 31, 2007 was due to lower conversion fees recognized as compared to the prior year period.

The $70 million increase in CFC interest income during the year ended May 31, 2007 as compared to the prior year was due to the increase in interest rates and loan volume partly offset by the impact of non-accrual loans. The impact on CFC interest income of non-accrual loans was a reduction of $39 million for the year ended May 31, 2007 as compared to $36 million for the prior year period. The impact of non-accrual loans on interest income is included in the rate variance in the chart above. The $24 million decrease in RTFC interest income during the year ended May 31, 2007 as compared to the prior year was due to the reduction in the balance of RTFC loans outstanding. The impact on RTFC interest income of non-accrual loans was a reduction of $42 million for the year ended May 31, 2007 as compared to $43 million for the prior year period.

Interest Expense

Total interest expense reported on the consolidated statements of operations and shown in the chart above includes the following and the weighted average interest rate thereon:

	For the year ended May 31,				
	2007		2006		
(Dollar amounts in millions)	Amount	Rate	Amount	Rate	Increase/ (Decrease)
Interest expense - commercial paper and bid notes (1)	$ 179		$ 133		$ 46
Interest expense - medium-term notes (1)	364		409		(45)
Interest expense - collateral trust bonds (1)	218		272		(54)
Interest expense - subordinated deferrable debt (1)	33		46		(13)
Interest expense - subordinated certificates (1)	48		47		1
Interest expense - long-term private debt (1)	119		46		