NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORP /DC/
Form 10-Q
April 04, 2016

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

FORM 10-Q

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x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended February 29, 2016
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	52-0891669
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)

20701 Cooperative Way, Dulles, Virginia, 20166
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (703) 467-1800

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x Smaller reporting company ¨
(Do not check if a smaller reporting company)

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

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

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains certain statements that are considered "forward-looking statements" within 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," " "expect," "continue," "potential," "opportunity" and similar expressions, whether in the negative or affirmative. All statements about future expectations or projections, including statements about loan volume, the appropriateness of the allowance for loan losses, operating income and expenses, leverage and debt-to-equity ratios, borrower financial performance, impaired loans, and sources and uses of liquidity, are forward-looking statements. Although we believe that the expectations reflected in our forward-looking statements are based on reasonable assumptions, actual results and performance may differ materially from our forward-looking statements due to several factors. Factors that could cause future results to vary from our forward-looking statements include, but are not limited to, general economic conditions, legislative changes including those that could affect our tax status, governmental monetary and fiscal policies, demand for our loan products, lending competition, changes in the quality or composition of our loan portfolio, changes in our ability to access external financing, changes in the credit ratings on our debt, valuation of collateral supporting impaired loans, charges associated with our operation or disposition of foreclosed assets, regulatory and economic conditions in the rural electric industry, non-performance of counterparties to our derivative agreements, the costs and effects of legal or governmental proceedings involving National Rural Utilities Cooperative Finance Corporation ("CFC") or its members and the factors listed and described under "Item 1A. Risk Factors" of our Annual Report on Form 10-K for the fiscal year ended May 31, 2015 ("2015 Form 10-K"). 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.

INTRODUCTION

National Rural Utilities Cooperative Finance Corporation ("CFC") is a member-owned cooperative association incorporated under the laws of the District of Columbia in April 1969. CFC's principal purpose is to provide its members with financing to supplement the loan programs of the Rural Utilities Service ("RUS") of the United States Department of Agriculture ("USDA"). CFC makes loans to its rural electric members so they can 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. As a cooperative, CFC is owned by and exclusively serves its membership, which consists of not-for-profit entities or subsidiaries or affiliates of not-for-profit entities. CFC is exempt from federal income taxes. As a member-owned cooperative, CFC's objective is not to maximize profit, but rather to offer its members cost-based financial products and services consistent with sound financial management.

Our financial statements include the consolidated accounts of CFC, Rural Telephone Finance Cooperative ("RTFC"), National Cooperative Services Corporation ("NCSC") and certain entities created and controlled by CFC to hold foreclosed assets. RTFC was established to provide private financing for the rural telecommunications industry. NCSC may provide financing to members of CFC, government or quasi-government entities which own electric utility systems that meet the Rural Electrification Act definition of "rural", and the for-profit and nonprofit entities that are owned, operated or controlled by, or provide significant benefits to certain members of CFC. CFC controlled and held foreclosed assets in two entities, Caribbean Asset Holdings, LLC ("CAH") and Denton Realty Partners, LP ("DRP"), during fiscal year 2015. DRP was dissolved during the fourth quarter of fiscal year 2015, subsequent to the sale of the remainder of its assets. CAH, which is the only entity in which we currently hold foreclosed assets, is a holding company for various U.S. Virgin Islands, British Virgin Islands and St. Maarten-based telecommunications operating entities that were transferred to CAH as a result of a loan default by a borrower and subsequent bankruptcy proceedings. These operating entities provide local, long-distance and wireless telephone, cable television and Internet services to residential and commercial customers. On September 30, 2015, CFC entered into a Purchase Agreement (the “Purchase Agreement”) with CAH, ATN VI Holdings, LLC (“Atlantic”) and Atlantic Tele-Network, Inc., the parent corporation of Atlantic, to sell all of the issued and outstanding membership interests

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of CAH to Atlantic for a purchase price of $145 million, subject to certain adjustments. See “Item 1. Business—Overview” of our 2015 Form 10-K for additional information on the business activities of each of these entities. Unless stated otherwise, references to “we,” “our” or “us” relate to CFC and its consolidated entities. All references to members within this document include members, associates and affiliates of CFC and its consolidated entities.

Management monitors a variety of key indicators to evaluate our business performance. The following MD&A is intended to provide the reader with an understanding of our results of operations, financial condition and liquidity by discussing the drivers of changes from period to period and the key measures used by management to evaluate performance, such as leverage ratios, growth and credit quality metrics. MD&A is provided as a supplement to, and should be read in conjunction with our unaudited condensed consolidated financial statements and related notes in this Report, the more detailed information contained in 2015 Form 10-K, including the risk factors discussed under “Part I—Item 1A. Risk Factors” in our 2015 Form 10-K, and the risk factors under “Part II—Item 1A. Risk Factors” in this Report.

SUMMARY OF SELECTED FINANCIAL DATA

Table 1 provides a summary of selected financial data for the three and nine months ended February 29, 2016 and February 28, 2015, and as of February 29, 2016 and May 31, 2015. In addition to financial measures determined in accordance with generally accepted accounting principles in the United States (“GAAP”), management also evaluates performance based on certain non-GAAP measures, which we refer to as “adjusted” measures. Our key non-GAAP metrics consist of adjusted times interest earned ratio (“adjusted TIER”) and adjusted debt-to-equity ratio. The most comparable GAAP measures are TIER and debt-to-equity ratio, respectively. The primary adjustments we make to calculate these non-GAAP measures consist of (i) adjusting interest expense and net interest income to include the impact of net periodic derivative cash settlements; (ii) adjusting net income, senior debt and total equity to exclude the non-cash impact of the accounting for derivative financial instruments; (iii) adjusting senior debt to exclude the amount that funds CFC member loans guaranteed by the RUS, subordinated deferrable debt and members’ subordinated certificates; and (iv) adjusting total equity to include subordinated deferrable debt and members’ subordinated certificates. See “Non-GAAP Financial Measures” for a detailed reconciliation of these adjusted measures to the most comparable GAAP measures. We believe our adjusted non-GAAP metrics, which are not a substitute for GAAP and may not be consistent with similarly titled non-GAAP measures used by other companies, provide meaningful information and are useful to investors because the financial covenants in our revolving credit agreements and debt indentures are based on these adjusted metrics.

Table 1: Summary of Selected Financial Data

(Dollars in thousands)	Three Months Ended February 29, 2016	Three Months Ended February 28, 2015	Change	Nine Months Ended February 29, 2016	Nine Months Ended February 28, 2015	Change
Statement of operations						
Interest income	$253,633	$238,740	6%	$756,074	$711,266	6%
Interest expense	(171,189)	(156,850)	9	(504,013)	(471,677)	7
Net interest income	82,444	81,890	1	252,061	239,589	5
Provision for loan losses	1,735	(2,304)	(175)	(4,067)	3,475	(217)
Fee and other income	5,604	5,020	12	17,336	19,249	(10)
Derivative losses(1)	(243,036)	(98,770)	146	(356,237)	(223,209)	60
Results of operations of foreclosed assets	1,472	(1,369)	(208)	1,605	(33,059)	(105)
Operating expenses(2)	(22,352)	(18,008)	24	(65,418)	(54,788)	19
Other non-interest expense	(842)	(710)	19	(1,208)	(653)	85
Loss before income taxes	(174,975)	(34,251)	411	(155,928)	(49,396)	216
Income tax benefit (expense)	593	55	978	153	(100)	(253)
Net loss	$(174,382)	$(34,196)	410%	$(155,775)	$(49,496)	215%
Adjusted statement of operations						
Adjusted interest expense(3)	$(193,745)	$(178,362)	9 %	$(569,298)	$(535,054)	6 %
Adjusted net interest income(3)	59,888	60,378	(1)	186,776	176,212	6
Adjusted net income(3)	46,098	43,062	7	135,177	110,336	23
Ratios						
Fixed-charge coverage ratio/TIER (4)	(0.02)	0.78	(80) bps	0.69	0.90	(21) bps
Adjusted TIER(3)	1.24	1.24	—	1.24	1.21	3

	February 29, 2016	May 31, 2015	Change
Balance sheet			
Cash, investments and time deposits	$724,085	$818,308	(12)%
Loans to members(5)	23,144,099	21,469,017	8
Allowance for loan losses	(37,918)	(33,690)	13
Loans to members, net	23,106,181	21,435,327	8
Total assets(6)	24,393,025	22,846,059	7
Short-term borrowings	3,309,020	3,127,754	6
Long-term debt	17,527,497	16,244,794	8
Subordinated deferrable debt	395,754	395,699	—
Members' subordinated certificates	1,444,515	1,505,420	(4)
Total debt outstanding(6)(7)	22,676,786	21,273,667	7
Total liabilities(6)	23,676,529	21,934,273	8
Total equity	716,496	911,786	(21)
Guarantees (8)	915,359	986,500	(7)

Ratios

Leverage ratio[9]	34.32	25.14	918	bps
Adjusted leverage ratio[3]	6.97	6.58	39	
Debt-to-equity ratio[10]	33.04	24.06	898	
Adjusted debt-to-equity ratio[3]	6.67	6.26	41	

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— Change is less than one percent or not meaningful.
(1)Consists of derivative cash settlements and derivative forward value amounts. Derivative cash settlement amounts represent net periodic contractual interest accruals related to derivatives not designated for hedge accounting. Derivative forward value amounts represent changes in fair value during the period, excluding net periodic contractual accruals, related to derivatives not designated for hedge accounting and expense amounts reclassified into income related to the cumulative transition loss recorded in accumulated other comprehensive income ("AOCI") as of June 1, 2001, as a result of the adoption of the derivative accounting guidance that required derivatives to be reported at fair value on the balance sheet.
(2)Consists of the salaries and employee benefits and the other general and administrative expenses components of non-interest expense, each of which are presented separately on our consolidated statements of operations.
(3)See "Non-GAAP Financial Measures" for details on the calculation of these adjusted non-GAAP ratios and the reconciliation to the most comparable GAAP measures.
(4)Calculated based on net income (loss) plus interest expense for the period divided by interest expense for the period. The fixed-charge coverage ratios and TIER were the same during each period presented because we did not have any capitalized interest during these periods.
(5)Loans to members consists of the outstanding principal balance of member loans plus unamortized deferred loan origination costs, which totaled $10 million as of both February 29, 2016 and May 31, 2015.
(6)In the first quarter of fiscal year 2016, we early-adopted the Financial Accounting Standards Board ("FASB") guidance that amends the presentation of debt issuance costs in the financial statements by requiring that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts, rather than as an asset. We retrospectively applied this guidance, which resulted in the reclassification of unamortized debt issuance costs of $47 million as of May 31, 2015, from total assets on our condensed consolidated balance sheet to total debt outstanding. Other than this reclassification, the adoption of the guidance did not impact our consolidated financial statements. See "Note 1—Summary of Significant Accounting Policies—Accounting Standards Adopted in Fiscal Year 2016" for additional information.
(7)Total debt includes debt issuance costs, which were previously classified as an asset on our consolidated balance sheets, of $53 million and $47 million as of February 29, 2016 and May 31, 2015, respectively.
(8)Represents the total outstanding guarantee amount as of the end of the each period; however, the amount recorded on our condensed consolidated balance sheets for our guarantee obligations is significantly less than the outstanding guarantee total. See "Note 10—Guarantees" for additional information.
(9)Calculated based on total liabilities and guarantees at period end divided by total equity at period end.
(10)Calculated based on total liabilities at period end divided by total equity at period end.

EXECUTIVE SUMMARY

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

We expect volatility in our reported GAAP results from period to period due to changes in market conditions and differences in the way our financial assets and liabilities are accounted for under GAAP. Our financial assets and liabilities expose us to interest-rate risk. We use derivatives, primarily interest rate swaps, as part of our strategy in managing this risk. Our derivatives are intended to economically hedge and manage the interest-rate sensitivity mismatch between our financial assets and liabilities. We are required under GAAP to carry derivatives at fair value on our consolidated balance sheet; however, our other financial assets and liabilities are carried at amortized cost.

Changes in interest rates and spreads result in periodic fluctuations in the fair value of our derivatives, which may cause volatility in our earnings because we do not apply hedge accounting. As a result, the mark-to-market changes in our derivatives are recorded in earnings. Based on the composition of our derivatives, we generally record derivative losses in earnings when interest rates decline and derivative gains when interest rates rise. This earnings volatility generally is not indicative of the underlying economics of our business, as the derivative forward fair value gains or losses recorded each period may or may not be realized over time, depending on future changes in market conditions and the terms of our derivative instruments. As such, management uses our adjusted non-GAAP results, which includes realized net periodic derivative settlements but excludes the impact of unrealized derivative forward fair value gains and losses, to evaluate our core operating performance. Because derivative forward fair value gains and losses do not impact our cash flows, liquidity or ability to service our debt costs, our financial debt covenants are also based on our adjusted non-GAAP results.

Financial Performance

Reported Results

We reported a net loss of $174 million, driven by derivative losses that totaled $243 million, for the quarter ended February 29, 2016 (“current quarter”). As a result, our results for the quarter provided no TIER coverage. The derivative losses were attributable to changes in interest rates and the shape of the yield curve during the quarter as longer-term interest rates decreased and the yield curve flattened. In comparison, we reported a net loss of $34 million, which was driven by derivative losses that totaled $99 million, and TIER of 0.78 for the same prior-year quarter. The significant increase in derivative losses in the current quarter over the same prior-year quarter more than offset the favorable impact of an increase in net interest income, which was driven by an increase in average total loans of $1,920 million, or 9%, from the same prior-year quarter.

We reported a net loss of $156 million, driven by derivatives losses that totaled $356 million, and a TIER of 0.69 for the nine months ended February 29, 2016. In comparison, we had a reported net loss of $49 million, which included derivative losses of $223 million, and a TIER of 0.90 for the nine months ended February 28, 2015. Similar to the current quarter, the increased derivative losses for the nine months ended February 29, 2016 more than offset the favorable impact of an increase in net interest income, driven by an increase in average total loans of $1,646 million, or 8%, from the same prior-year period and the absence of the CAH impairment charge of $27 million recorded in the same prior-year period. Our debt-to-equity ratio increased to 33.04-to-1 as of February 29, 2016, from 24.06-to-1 as of May 31, 2015, largely due to our reported net loss for the period.

Adjusted Non-GAAP Results

Our adjusted net income totaled $46 million and $43 million for the current quarter and same prior-year quarter, respectively, and our adjusted TIER was 1.24 for each period. The increase in adjusted net income was attributable to the combined impact of a favorable shift in the provision for loan losses and results from foreclosed assets, which were partially offset by an increase in operating expenses.

Our adjusted net income was $135 million and $110 million for the nine months ended February 29, 2016 and February 28, 2015, respectively, and our adjusted TIER was 1.24 and 1.21, respectively, for the same prior-year period. The increase in adjusted net income was primarily driven by an increase in adjusted net interest income resulting from the growth in average total loan balances during the nine months ended February 29, 2016, as noted above, and the absence of the CAH impairment charge of $27 million recorded in the second quarter of 2015. Our adjusted debt-to-equity ratio increased to 6.67-to-1 as of February 29, 2016 from 6.26-to-1 as of May 31, 2015, due to a 7% increase in our debt outstanding to fund the growth in our loan portfolio.

Lending Activity

Total loans outstanding, which consists of the unpaid principal balance and excludes deferred loan origination costs, was $23,134 million as of February 29, 2016, an increase of $1,675 million, or 8%, from May 31, 2015. The increase was primarily due to an increase in CFC distribution and power supply loans of $1,606 million and $141 million, respectively, which was largely attributable to members refinancing with us loans made by other lenders and member advances for capital investments. This increase was partially offset by a decrease in NCSC and RTFC loans of $34 million and $28 million, respectively.

CFC had long-term fixed-rate loans totaling $923 million that repriced during the nine months ended February 29, 2016. Of this total, $864 million repriced to a new long-term fixed rate; $44 million repriced to a long-term variable rate; and $15 million were repaid in full.

Financing Activity

Our outstanding debt volume generally increases and decreases in response to member loan demand. As outstanding loan balances increased during the nine months ended February 29, 2016, our debt volume also increased. Total debt outstanding was $22,677 million as of February 29, 2016, an increase of $1,403 million, or 7%, from May 31, 2015. The increase was primarily attributable to a net increase of $402 million under the note purchase agreement with the Federal Agricultural Mortgage Corporation (“Farmer Mac”), a net increase of $380 million under the Guaranteed Underwriter Program of the USDA and a net increase of $494 million in collateral trust bonds.

In July 2015, we executed a new three-year $300 million secured revolving note purchase agreement with Farmer Mac to provide us additional funding flexibility. In November 2015, we amended and restated our $1,665 million three-year and $1,645 million five-year revolving credit agreements to extend the maturity dates to November 19, 2018 and November 19, 2020, respectively, from October 28, 2017 and October 28, 2019, respectively. We provide additional information on our financing activities below under “Consolidated Balance Sheet Analysis—Debt” and “Liquidity Risk.”

Outlook for the Next 12 Months

We expect the amount of new long-term loan advances to exceed scheduled loan repayments over the next 12 months. We anticipate a continued increase in earnings from our core lending operations over the next 12 months based on our expectation of an increase in long-term loans outstanding.

Long-term debt scheduled to mature over the next 12 months totaled $1,355 million as of February 29, 2016. We believe we have sufficient liquidity from the combination of existing cash and time deposits, member loan repayments, committed loan facilities and our ability to issue debt in the capital markets, to our members and in private placements, to meet the demand for member loan advances and satisfy our obligations to repay long-term debt maturing over the next 12 months. We had $639 million in cash and cash equivalents and time deposits, up to $350 million available under committed loan facilities from the Federal Financing Bank (“FFB”), $3,309 million available under committed revolving lines of credit with a syndicate of banks, up to $300 million available under a new note purchase agreement with Farmer Mac and, subject to market conditions, up to $2,187 million available under the existing revolving note purchase agreement with Farmer Mac as of February 29, 2016. On March 29, 2016, we closed on a $250 million committed loan facility (“Series K”) from the FFB guaranteed by the RUS pursuant to the Guaranteed Underwriter Program. Under the Series K facility, we are able to borrow any time before January 15, 2019, with each advance having a final maturity no longer than 20 years from the advance date. This new commitment increases total funding available to CFC under committed loan facilities from the FFB to $600 million. We also have the ability to issue collateral trust bonds and medium-term notes in the capital markets and medium-term notes to members.

We believe we can continue to roll over the member outstanding short-term debt of $2,354 million as of February 29, 2016, based on our expectation that our members will continue to reinvest their excess cash in our commercial paper, daily liquidity fund and select notes. We expect to continue to roll over our outstanding dealer commercial paper of $955 million as of February 29, 2016. We intend to manage our short-term wholesale funding risk by maintaining a balance on our dealer commercial paper below $1,250 million for the foreseeable future. We expect to continue to be in compliance with the covenants under our revolving credit agreements, which will allow us to mitigate our roll-over risk as we can draw on these facilities to repay dealer or member commercial paper that cannot be rolled over due to potential adverse changes in market conditions.

Our goal is to achieve and maintain the adjusted debt-to-equity ratio at or below 6.00-to-1. However, because of the significant increase in outstanding loan balances over the last 18 months, it has been necessary to increase our borrowings to fund the loan growth. As a result, our adjusted debt-to-equity ratio was higher than 6.00-to-1 as of February 29, 2016. We intend to take actions over the next 12 months to reduce our adjusted debt-to-equity ratio to a level closer to our targeted ratio of 6.00-to-1 or below.

As part of our strategy in managing our credit risk exposure, we entered into a long-term standby purchase commitment agreement with Farmer Mac on August 31, 2015. Under this agreement, we may designate certain loans, as approved by Farmer Mac, and in the event any such loan later goes into material default for at least 90 days, upon request by us, Farmer Mac must purchase such loan at par value. We designated, and Farmer Mac approved an initial tranche of loans with an aggregate outstanding principal balance of $520 million as of August 31, 2015. As a result of principal payments, the balance of these loans totaled $511 million as of February 29, 2016. We may designate additional loans in the future under the long-term standby purchase commitment agreement with Farmer Mac.

As previously disclosed, on September 30, 2015, CFC entered into a Purchase Agreement with CAH, Atlantic and Atlantic Tele-Network, Inc., the parent corporation of Atlantic, to sell all of the issued and outstanding membership interests of CAH to Atlantic for a purchase price of $145 million, subject to certain adjustments. The amount recorded on our condensed consolidated balance sheet for CAH of $118 million as of February 29, 2016 reflects the expected net proceeds from the completion of the CAH sales transaction. The expected net proceeds is based on the contractual purchase price of $145 million, plus agreed-upon purchase price adjustments less estimated selling costs.

We continue to expect to complete the transaction during the second half of calendar year 2016, subject to the satisfaction or waiver of various closing conditions under the Purchase Agreement, including, among other things, the receipt of required communications regulatory approvals in the United States, United States Virgin Islands, British Virgin Islands and St. Maarten, the expiration or termination of applicable waiting periods under applicable competition laws, and the absence of a material adverse effect or material adverse regulatory event. See “Consolidated Results of Operations—Results of Foreclosed Assets” below and “Note 4—Foreclosed Assets” for additional information related to CAH.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in accordance with GAAP requires management to make a number of judgments, estimates and assumptions that affect the amount of assets, liabilities, income and expenses in the consolidated financial statements. Understanding our accounting policies and the extent to which we use management's judgment and estimates in applying these policies is integral to understanding our financial statements. We provide a discussion of our significant accounting policies under “Note 1—Summary of Significant Accounting Policies” in our 2015 Form 10-K.

We have identified certain accounting policies as critical because they involve significant judgments and assumptions about highly complex and inherently uncertain matters, and the use of reasonably different estimates and assumptions could have a material impact on our results of operations or financial condition. Our most critical accounting policies and estimates involve the determination of the allowance for loan losses and fair value. We evaluate our critical accounting estimates and judgments required by our policies on an ongoing basis and update them as necessary based on changing conditions. There were no material changes in the assumptions used in our critical accounting policies and estimates during the current quarter. Management has discussed significant judgments and assumptions in applying our critical accounting policies with the Audit Committee of our Board of Directors. We provide information on the methodologies and key assumptions used in our critical accounting policies and estimates under “MD&A—Critical Accounting Policies and Estimates” in our 2015 Form 10-K. See “Item 1A. Risk Factors” for a discussion of the risks associated with management’s judgments and estimates in applying our accounting policies and methods in our 2015 Form 10-K.

ACCOUNTING CHANGES AND DEVELOPMENTS

See “Note 1—Summary of Significant Accounting Policies” for information on accounting standards adopted during the nine months ended February 29, 2016, as well as recently issued accounting standards not yet required to be adopted and the expected impact of these accounting standards. To the extent we believe the adoption of new accounting standards has had or will have a material impact on our results of operations, financial condition or liquidity, we discuss the impacts in the applicable section(s) of MD&A.

CONSOLIDATED RESULTS OF OPERATIONS

The section below provides a comparative discussion of our condensed consolidated results of operations between the three months ended February 29, 2016 and February 28, 2015 and between the nine months ended February 29, 2016 and February 28, 2015. Following this section, we provide a comparative analysis of our condensed consolidated balance sheets as of February 29, 2016 and May 31, 2015. You should read these sections together with our "Executive Summary—Outlook for the Next 12 Months" where we discuss trends and other factors that we expect will affect our future results of operations.

Net Interest Income

Net interest income represents the difference between the interest income and applicable fees earned on our interest-earning assets, which include loans and investment securities, and the interest expense on our interest-bearing liabilities. Our net interest yield represents the difference between the yield on our interest-earning assets and the cost of our interest-bearing liabilities plus the impact from non-interest bearing funding. We expect net interest income and our net interest yield to fluctuate based on changes in interest rates and changes in the amount and composition of our interest-earning assets and interest-bearing liabilities. We do not fund each individual loan with specific debt. Rather, we attempt to minimize costs and maximize efficiency by funding large aggregated amounts of loans.

Table 2 presents our average balance sheets for the three and nine months ended February 29, 2016 and February 28, 2015, and for each major category of our interest-earning assets and interest-bearing liabilities, the interest income earned or interest expense incurred, and the average yield or cost. Table 2 also presents non-GAAP adjusted interest expense, adjusted net interest income and adjusted net interest yield, which reflect the inclusion of net accrued periodic derivative cash settlement in interest expense. We provide reconciliations of our non-GAAP adjusted measures to the most comparable GAAP measures under "Non-GAAP Financial Measures."

Table 2: Average Balances, Interest Income/Interest Expense and Average Yield/Cost

(Dollars in thousands)	Three Months Ended February 29, 2016				February 28, 2015			
Assets:	Average Balance	Interest Income/Expense	Average Yield/Cost		Average Balance	Interest Income/Expense	Average Yield/Cost	
Long-term fixed-rate loans(1)	$21,105,238	$ 240,933	4.59	%	$19,134,746	$ 224,770	4.76	%
Long-term variable-rate loans	732,970	5,077	2.79		667,788	4,836	2.94	
Line of credit loans	1,032,204	6,335	2.47		1,159,097	6,707	2.35	
Restructured loans	12,737	163	5.15		7,534	—	—	
Nonperforming loans	7,772	81	4.19		1,690	—	—	
Interest-based fee income(2)	—	(279)	—		—	32	—	
Total loans	22,890,921	252,310	4.43		20,970,855	236,345	4.57	
Cash, investments and time deposits	645,268	1,323	0.82		761,963	2,395	1.27	
Total interest-earning assets	$23,536,189	$ 253,633	4.33	%	$21,732,818	$ 238,740	4.46	%
Other assets, less allowance for loan losses	756,264				597,952			
Total assets	$24,292,453				$22,330,770			
Liabilities:								
Short-term debt	$3,308,003	$ 4,387	0.53	%	$3,844,060	$ 2,982	0.31	%
Medium-term notes	3,457,086	21,773	2.53		2,909,343	17,774	2.48	
Collateral trust bonds	6,973,746	83,810	4.83		6,240,729	79,026	5.14	
Subordinated deferrable debt	395,741	4,785	4.86		400,000	4,782	4.85	
Subordinated certificates	1,421,538	15,022	4.25		1,493,438	15,280	4.15	
Long-term notes payable	6,809,807	41,412	2.45		5,998,620	37,006	2.50	
Total interest-bearing liabilities	$22,365,921	$ 171,189	3.08	%	$20,886,190	$ 156,850	3.05	%
Other liabilities	1,075,182				483,087			
Total liabilities	23,441,103				21,369,277			
Total equity	851,350				961,493			
Total liabilities and equity	$24,292,453				$22,330,770			
Net interest spread(3)			1.25	%			1.41	%
Impact of non-interest bearing funding(4)			0.15				0.10	
Net interest income/net interest yield(5)		$ 82,444	1.40	%		$ 81,890	1.51	%
Adjusted net interest income/adjusted net interest yield:								
Interest income		$ 253,633	4.33	%		$ 238,740	4.46	%
Interest expense		171,189	3.08			156,850	3.05	
Add: Net accrued periodic derivative cash settlements(6)		22,556	0.90			21,512	0.99	
Adjusted interest expense(7)		$ 193,745	3.48	%		$ 178,362	3.45	%
Adjusted net interest spread(3)			0.85	%			1.01	%
			0.17				0.12	

Impact of non-interest bearing funding				
Adjusted net interest income/adjusted net interest yield[8]	$ 59,888	1.02 %	$ 60,378	1.13 %

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(Dollars in thousands)	Nine Months Ended February 29, 2016				February 28, 2015			
Assets:	Average Balance	Interest Income/Expense	Average Yield/Cost		Average Balance	Interest Income/Expense	Average Yield/Cost	
Long-term fixed-rate loans[1]	$20,509,790	$ 716,736	4.67	%	$18,758,101	$ 669,121	4.77	%
Long-term variable-rate loans	703,489	14,919	2.83		705,736	15,099	2.86	
Line of credit loans	1,043,293	18,919	2.42		1,152,417	20,335	2.36	
Restructured loans	11,492	293	3.41		7,558	10	0.18	
Nonperforming loans	3,507	110	4.19		1,820	—	—	
Interest-based fee income[2]	—	(808)	—		—	185	—	
Total loans	22,271,571	750,169	4.50		20,625,632	704,750	4.57	
Cash, investments and time deposits	666,755	5,905	1.18		826,981	6,516	1.05	
Total interest-earning assets	$22,938,326	$ 756,074	4.40	%	$21,452,613	$ 711,266	4.43	%
Other assets, less allowance for loan losses	836,066				878,157			
Total assets	$23,774,392				$22,330,770			
Liabilities:								
Short-term debt	$3,084,884	$ 10,311	0.45	%	$3,823,206	$ 11,786	0.41	%
Medium-term notes	3,395,871	62,745	2.47		2,844,148	52,640	2.47	
Collateral trust bonds	6,805,318	248,410	4.88		6,111,864	232,290	5.08	
Subordinated deferrable debt	395,723	14,356	4.85		400,000	14,352	4.80	
Subordinated certificates	1,463,180	45,425	4.15		1,520,276	48,131	4.23	
Long-term notes payable	6,699,774	122,766	2.45		5,876,077	112,478	2.56	
Total interest-bearing liabilities	$21,844,750	$ 504,013	3.08	%	$20,575,571	$ 471,677	3.06	%
Other liabilities	1,032,779				793,706			
Total liabilities	22,877,529				21,369,277			
Total equity	896,863				961,493			
Total liabilities and equity	$23,774,392				$22,330,770			
Net interest spread[3]			1.32	%			1.37	%
Impact of non-interest bearing funding[4]			0.15				0.12	
Net interest income/net interest yield[5]		$ 252,061	1.47	%		$ 239,589	1.49	%
Adjusted net interest income/adjusted net interest yield:								
Interest income		$ 756,074	4.40	%		$ 711,266	4.43	%
Interest expense		504,013	3.08			471,677	3.06	
Add: Net accrued periodic derivative cash settlements[6]		65,285	0.88			63,377	0.99	
Adjusted interest expense[7]		$ 569,298	3.48	%		$ 535,054	3.48	%
Adjusted net interest spread[3]			0.92	%			0.95	%
Impact of non-interest bearing funding			0.17				0.15	

Adjusted net interest income/adjusted net interest yield[8]	$	186,776	1.09 %	$	176,212	1.10 %

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[1]Interest income includes loan conversion fees, which are generally deferred and recognized in interest income using the effective interest method. A small portion of conversion fees that are intended to cover the administrative costs related to the conversion are recognized into interest income immediately at the date of conversion.
[2]Amounts primarily include the amortization of deferred loan origination costs and late payment fees. Excludes up-front loan arranger fees, which are not based on interest rates, for the three and nine months ended February 29, 2016. These fees are included in fee and other income.

(3)Net interest spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing funding. Adjusted net interest spread represents the difference between the average yield on interest-earning assets and the adjusted average cost of interest-bearing funding.
(4)Includes other liabilities and equity.
(5)Net interest yield is calculated based on annualized net interest income for the period divided by average interest-earning assets for the period.
(6)Represents the impact of net accrued periodic derivative cash settlements during the period, which is added to interest expense to derive non-GAAP adjusted interest expense. The average (benefit)/cost associated with derivatives is calculated based on the annualized net accrued periodic settlements during the period divided by the average outstanding notional amount of derivatives during the period. The average outstanding notional amount of derivatives was $10,078 million and $8,791 million for the three months ended February 29, 2016 and February 28, 2015, respectively. The average outstanding notional amount of derivatives was $9,930 million and $8,588 million for the nine months ended February 29, 2016 and February 28, 2015, respectively.
(7)Adjusted average cost is calculated based on annualized adjusted interest expense for the period divided by average interest-bearing funding during the period.
(8)Adjusted net interest yield is calculated based on annualized adjusted net interest income for the period divided by average interest-earning assets for the period.

Table 3 displays the change in our net interest income between periods and the extent to which the variance is attributable to: (i) changes in the volume of our interest-earning assets and interest-bearing liabilities or (ii) changes in the interest rates of these assets and liabilities. The table also presents the change in adjusted net interest income between periods.

Table 3: Rate/Volume Analysis of Changes in Interest Income/Interest Expense

	Three Months Ended February 29, 2016 versus February 28, 2015			Nine Months Ended February 29, 2016 versus February 28, 2015		
		Variance due to:(1)			Variance due to:(1)	
(Dollars in thousands)	Total Variance	Volume	Rate	Total Variance	Volume	Rate
Interest income:						
Long-term fixed-rate loans	$16,163	$25,216	$(9,053)	$47,615	$63,158	$(15,543)
Long-term variable-rate loans	241	516	(275)	(180)	(34)	(146)
Line of credit loans	(372)	(684)	312	(1,416)	(1,909)	493
Restructured loans	163	—	163	283	5	278
Nonperforming loans	81	—	81	110	—	110
Fee income	(311)	—	(311)	(993)	—	(993)
Total loans	15,965	25,048	(9,083)	45,419	61,220	(15,801)
Cash, investments and time deposits	(1,072)	(350)	(722)	(611)	(1,258)	647
Interest income	14,893	24,698	(9,805)	44,808	59,962	(15,154)
Interest expense:						
Short-term debt	1,405	(394)	1,799	(1,475)	(2,267)	792
Medium-term notes	3,999	3,523	476	10,105	10,269	(164)
Collateral trust bonds	4,784	10,019	(5,235)	16,120	26,594	(10,474)
Subordinated deferrable debt	3	(11)	14	4	(140)	144
Subordinated certificates	(258)	(614)	356	(2,706)	(1,765)	(941)
Long-term notes payable	4,406	5,355	(949)	10,288	15,885	(5,597)
Interest expense	14,339	17,878	(3,539)	32,336	48,576	(16,240)
Net interest income	$554	$6,820	$(6,266)	$12,472	$11,386	$1,086
Adjusted net interest income:						
Interest income	$14,893	$24,698	$(9,805)	$44,808	$59,962	$(15,154)
Interest expense	14,339	17,878	(3,539)	32,336	48,576	(16,240)
Net accrued periodic derivative cash settlements(2)	1,044	3,367	(2,323)	1,908	9,972	(8,064)
Adjusted interest expense(3)	15,383	21,245	(5,862)	34,244	58,548	(24,304)
Adjusted net interest income	$(490)	$3,453	$(3,943)	$10,564	$1,414	$9,150

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(1)The changes for each category of interest income and interest expense are divided between the portion of change attributable to the variance in volume and the portion of change attributable to the variance in rate for that category. The amount attributable to the combined impact of volume and rate has been allocated to each category based on the proportionate absolute dollar amount of change for that category.
(2)For net accrued periodic derivative cash settlements, the variance due to average volume represents the change in derivative cash settlements resulting from the change in the average notional amount of derivative contracts outstanding. The variance due to average rate represents the change in derivative cash settlements resulting from the net difference between the average rate paid and the average rate received for interest rate swaps during the period.
(3) See “Non-GAAP Financial Measures” for additional information on our adjusted non-GAAP measures.

Net interest income of $82 million for the current quarter increased by $1 million, or 1%, from the same prior-year quarter, driven by an increase in average interest-earning assets of 8%, which was partially offset a decrease in net interest yield of 7% (11 basis points) to 1.40%.

Net interest income of $252 million for the nine months ended February 29, 2016 increased by $12 million, or 5%, from the same prior-year period, driven by an increase in average interest-earning assets of 7%, which was partially offset by a decrease in net interest yield of 1% (2 basis points) to 1.47%.

- Average Interest-Earning Assets: The increase in average interest-earning assets for the current quarter and nine months ended February 29, 2016 was primarily attributable to growth in average total loans of $1,920 million, or 9%, and $1,646 million, or 8%, respectively, over the same prior-year periods, as members refinanced with us loans made by other lenders and obtained advances to fund capital investments.

- Net Interest Yield: The decrease in the net interest yield for the current quarter and for the nine months ended February 29, 2016 reflects the combined impact of a modest increase in our average cost of funds and a decline in the average yield on interest-earning assets. Our average cost of funds increased by 3 basis points and 2 basis points, respectively, during the current quarter and nine months ended February 29, 2016 to 3.08% for each period. This increase was largely due to our decision in the third quarter of fiscal year 2015 to significantly reduce the level of outstanding dealer commercial paper balance, which has a much lower cost than our other funding options. The decrease in the average yield on interest-earning assets of 13 basis points to 4.33% and of 3 basis points to 4.40%, respectively, during the current quarter and nine months ended February 29, 2016, respectively, was largely attributable to reduced rates on fixed-rate loans, reflecting the repricing of higher rate loans to lower interest rates and lower interest rates on new loan originations as a result of the overall low interest rate environment.

Adjusted net interest income of $60 million for the current quarter represented a slight decrease from the same prior-year quarter, attributable to a decrease in the adjusted net interest yield of 10% (11 basis points) to 1.02%, which was partially offset by the increase in average interest-earning assets of 8%. The decrease in the adjusted net interest yield also reflected the combined impact of an increase in our average cost of funds resulting from actions taken in the third quarter of fiscal year 2015 to significantly reduce the level of lower-cost dealer commercial paper, coupled with the decline in the average yield on interest-earning assets.

Adjusted net interest income of $187 million for the nine months ended February 29, 2016 increased by $11 million, or 6%, from the same prior-year period, driven by the increase in average interest-earning assets of 7%, which was partially offset by a decrease in the adjusted net interest yield of 1% (1 basis point) to 1.09%.

Our adjusted net interest income and adjusted net interest yield include the impact of net accrued periodic derivative cash settlements during the period. We recorded net periodic derivative cash settlement expense of $23 million and $22 million for the three months ended February 29, 2016 and February 28, 2015, respectively, and $65 million and $63 million for the nine months ended February 29, 2016 and February 28, 2015, respectively. See “Non-GAAP Financial Measures” for additional information on our adjusted measures.

Provision for Loan Losses

Our provision for loan losses in each period is primarily driven by the level of allowance that we determine is necessary for probable incurred loan losses inherent in our loan portfolio as of each balance sheet date.

We recorded a benefit for loan losses of $2 million during the three months ended February 29, 2016, compared with a provision of $2 million for the same prior-year period. We recorded a provision for loan losses of $4 million for the nine months ended February 29, 2016, compared with a benefit of $3 million for the nine months ended February 28, 2015. The increase in individually impaired loans was the primary driver of the provision of $4 million for the nine months ended February 29, 2016. In comparison, outstanding loans remained relatively flat during the same prior-year period, and we experienced modest improvement in the credit quality and overall credit risk profile of our loan portfolio, which together resulted in the benefit of $3 million for the nine months ended February 28, 2015.

We provide additional information on our allowance for loan losses under “Credit Risk—Allowance for Loan Losses” and “Note 3—Loans and Commitments” of this Report. For information on our allowance methodology, see “MD&A—Critical

Accounting Policies and Estimates” and “Note 1—Summary ” in our 2015 Form 10-K.

Non-Interest Income

Non-interest income consists of fee and other income, gains and losses on derivatives not accounted for in hedge accounting relationships and results of operations of foreclosed assets.

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We recorded losses from non-interest income of $236 million and $95 million for the three months ended February 29, 2016 and February 28, 2015, respectively. We recorded losses from non-interest income of $337 million and $237 million for the nine months ended February 29, 2016 and February 28, 2015, respectively. The variances in non-interest income for three and nine months ended February 29, 2016, from the same prior-year periods were primarily attributable to changes in net derivative losses recognized in our consolidated statements of operations and an impairment charge of $27 million related to CAH recorded in the nine months ended February 28, 2015.

Derivative Gains (Losses)

Our derivative instruments are an integral part of our interest rate risk management strategy. Our principal purpose in using derivatives is to manage our aggregate interest rate risk profile within prescribed risk parameters. The derivative instruments we use primarily include interest rate swaps, which we typically hold to maturity. The primary factors affecting the fair value of our derivatives and derivative gains (losses) recorded in our results of operations include changes in interest rates, the shape of the yield curve and the composition of our derivative portfolio. We generally do not designate interest rate swaps, which presently account for all of our derivatives, for hedge accounting. Accordingly, changes in the fair value of interest rate swaps are reported in our consolidated statements of operations under derivative gains (losses). We did not have any derivatives designated as accounting hedges as of February 29, 2016 or May 31, 2015.

We currently use two types of interest rate swap agreements: (i) we pay a fixed rate and receive a variable rate (“pay-fixed swaps”) and (ii) we pay a variable rate and receive a fixed rate (“receive-fixed swaps”). The benchmark rate for the substantial majority of the floating rate payments under our swap agreements is the London Interbank Offered Rate (“LIBOR”). Table 4 displays the average notional amount outstanding, by swap agreement type, and the weighted-average interest rate paid and received for derivative cash settlements during the three and nine months ended February 29, 2016 and February 28, 2015. As indicated in Table 4, our derivative portfolio currently consists of a higher proportion of pay-fixed swaps than receive-fixed swaps, which is subject to variations based on changes in market conditions and actions taken to manage our interest rate risk.

Table 4: Derivative Average Notional Balances and Average Interest Rates

	Three Months Ended									
	February 29, 2016					February 28, 2015				
(Dollars in thousands)	Average Notional Balance	Weighted-Average Rate Paid		Weighted-Average Rate Received		Average Notional Balance	Weighted-Average Rate Paid		Weighted-Average Rate Received	
Pay-fixed swaps	$6,476,600	3.00	%	0.54	%	$5,579,367	3.24	%	0.26	%
Receive-fixed swaps	3,601,198	0.94		2.93		3,211,222	0.84		3.47	
Total	$10,077,798	2.25	%	1.41	%	$8,790,589	2.38	%	1.41	%
	Nine Months Ended									
	February 29, 2016					February 28, 2015				
(Dollars in thousands)	Average Notional Balance	Weighted-Average Rate Paid		Weighted-Average Rate Received		Average Notional Balance	Weighted-Average Rate Paid		Weighted-Average Rate Received	
Pay-fixed swaps	$6,202,082	3.06	%	0.39	%	$5,513,549	3.29	%	0.25	%
Receive-fixed swaps	3,728,197	0.85		3.01		3,074,549	0.84		3.56	
Total	$9,930,279	2.22	%	1.38	%	$8,588,098	2.41	%	1.43	%

The average remaining maturity of our pay-fixed swaps was 18 years, and the average remaining maturity of our receive-fixed swaps was three years as of February 29, 2016.

Pay-fixed swaps generally decrease in value as interest rates decline and increase in value as interest rates rise. In contrast, receive-fixed swaps generally increase in value as interest rates decline and decrease in value as interest rates rise. Because our pay-fixed and receive-fixed swaps are referenced to different maturity terms along the swap yield curve, different changes in the swap yield curve— parallel, flattening or steepening—will result in differences in the fair value of our derivatives. See “Note 14—Fair Value of Financial Instruments” to the Consolidated Financial Statements in our 2015 Form 10-K for information on how we estimate the fair value of our derivative instruments. The chart below provides comparative yield curves as of the end of each reporting period in the current year and as of the end of the same prior-year reporting periods.

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Benchmark rates obtained from Bloomberg.

We recorded derivative losses of $243 million and $99 million for the three months ended February 29, 2016 and February 28, 2015, respectively, and derivative losses of $356 million and $223 million for the nine months ended February 29, 2016 and February 28, 2015, respectively. Table 5 presents the components of net derivative gains (losses) recorded in our condensed consolidated results of operations for the three and nine months ended February 29, 2016 and February 28, 2015. Derivative cash settlements represent the net interest amount we accrue during a period for interest-rate swap payments. The derivative forward value represents the change in fair value of our interest rate swaps during the reporting period due to changes in expected future interest rates over the remaining life of our derivative contracts.

Table 5: Derivative Gains (Losses)

(Dollars in thousands)	Three Months Ended February 29, 2016	Three Months Ended February 28, 2015	Nine Months Ended February 29, 2016	Nine Months Ended February 28, 2015
Derivative losses attributable to:				
Derivative cash settlements	$(22,556)	$(21,512)	$(65,285)	$(63,377)
Derivative forward value	(220,480)	(77,258)	(290,952)	(159,832)
Derivative losses	$(243,036)	$(98,770)	$(356,237)	$(223,209)

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The derivative losses of $243 million and $356 million recorded in the three and nine months ended February 29, 2016, were primarily attributable to a net decrease in the fair value of our swaps due to a flattening of the swap yield curve resulting from an increase in short-term interest rates and a decline in long-term interest rates, as depicted in the February 29, 2016 yield curve presented in the above chart. This flattening of the yield curve was more pronounced during the current quarter, as the U.S. Federal Reserve raised the short-term federal funds rate by 25 basis points in December 2015, the first rate change since the federal funds rate was lowered to near zero seven years ago. As shorter-term rates increased, longer-term rates declined to near record lows during the current quarter amid increased market volatility, a drop in oil prices and global market uncertainty.

The net derivative losses of $99 million and $223 million recorded for the three and nine months ended February 28, 2015, respectively, were primarily attributable to a flattening of the swap yield curve during the period, as interest rates on the longer end of the yield curve declined while short-interest rates rose. The decline in longer-term rates resulted in a net decrease in the fair value of our pay-fixed swaps and the increase in shorter-term rates resulted in an overall decrease in the fair value of our receive-fixed swaps.

See “Note 8—Derivative Financial Instruments” for additional information on our derivative instruments.

Results of Operations of Foreclosed Assets

The financial operating results of entities controlled by CFC that hold foreclosed assets are reported in our consolidated statements of operations under results of operations of foreclosed assets. We previously had two entities, CAH and DRP, that held foreclosed assets. We dissolved DRP during the fourth quarter of fiscal 2015, following the sale of DRP’s remaining assets.

We recorded a gain from the results of operations of foreclosed assets of $1 million and $2 million, respectively, for the three and nine months ended February 29, 2016, compared to a loss of $1 million and $33 million, respectively, for the same prior-year periods. The gain recorded during the three and nine months ended February 29, 2016 was primarily attributable to purchase price adjustments related to CAH, while the losses recorded during the prior-year periods were primarily attributable to CAH’s operating losses and to an impairment charge during the nine months ended February 29, 2016 of $27 million recorded in the second quarter of fiscal year 2015.

As discussed above under “Introduction” and “Executive Summary,” on September 30, 2015, CFC entered into a Purchase Agreement with CAH, Atlantic and Atlantic Tele-Network, Inc., the parent corporation of Atlantic, to sell all of the issued and outstanding membership interests of CAH to Atlantic for a purchase price of $145 million, subject to certain adjustments. The amount recorded on our condensed consolidated balance sheet for CAH of $118 million as of February 29, 2016 reflects the expected net proceeds from the completion of the CAH sales transaction. The expected net proceeds is based on the contractual purchase price of $145 million, plus agreed-upon purchase price adjustments less estimated selling costs.

We expect to complete the transaction during the second half of calendar year 2016, subject to the satisfaction or waiver of various closing conditions under the Purchase Agreement, including, among other things, the receipt of required communications regulatory approvals in the United States, United States Virgin Islands, British Virgin Islands and St. Maarten, the expiration or termination of applicable waiting periods under applicable competition laws, and the absence of a material adverse effect or material adverse regulatory event.

Non-Interest Expense

Non-interest expense consists of salaries and employee benefit expense, general and administrative expenses, losses on early extinguishment of debt and other miscellaneous expenses.

We recorded non-interest expense of $23 million and $19 million for the three months ended February 29, 2016 and February 28, 2015, respectively, and non-interest expense of $67 million and $55 million for the nine months ended February 29, 2016 and February 28, 2015, respectively. The increase for the current year periods over the same prior-year periods was primarily attributable to an increase in salaries and employee benefit expense, costs related to system infrastructure enhancements and higher legal fees.

Net Income (Loss) Attributable to Noncontrolling Interests

Net income (loss) attributable to noncontrolling interests represents 100% of the results of operations of RTFC and NCSC, as the members of RTFC and NCSC own or control 100% of the interest in their respective companies. The fluctuations in net income (loss) attributable to noncontrolling interests are primarily due to fluctuations in the fair value of NCSC's derivative instruments.

We recorded a net loss attributable to noncontrolling interests of $1 million and $2 million, respectively, for the three and nine months ended February 29, 2016, and a net loss of less than $1 million during the same prior-year periods.

CONSOLIDATED BALANCE SHEET ANALYSIS

Total assets of $24,393 million as of February 29, 2016 increased by $1,547 million, or 7%, from May 31, 2015, primarily due to growth in our loan portfolio. Total liabilities of $23,677 million as of February 29, 2016 increased by $1,742 million, or 8%, from May 31, 2015, primarily due to debt issuances to fund our loan portfolio growth. Total equity decreased by $195 million to $716 million as of February 29, 2016. The decrease in total equity for the nine months ended February 29, 2016 was primarily attributable to the net loss of $156 million and to the patronage capital retirement of $39 million in September 2015.

Following is a discussion of changes in the major components of our assets and liabilities during the nine months ended February 29, 2016. Period-end balance sheet amounts may vary from average balance sheet amounts due to liquidity and balance sheet management activities that are intended to manage liquidity requirements for the company and our customers and our market risk exposure in accordance with our risk appetite.

Loan Portfolio

We offer long-term fixed- and variable-rate loans and line of credit variable-rate loans. Borrowers may choose a fixed or variable interest rate for periods of one to 35 years. When a selected fixed-rate term expires, the borrower may select either another fixed-rate term or a variable rate or elect to repay the loan in full. We also offer a conversion option to members with long-term loan agreements, which allows borrowers to change the rate and term prior to the repricing date. Borrowers are generally charged a conversion fee when converting from a fixed to a variable rate, or a fixed rate to another fixed rate.

Table 6 summarizes total loans outstanding, by type and by member class, as of February 29, 2016 and May 31, 2015.

Table 6: Loans Outstanding by Type and Member Class

	February 29, 2016		May 31, 2015		Increase/
(Dollars in thousands)	Amount	% of Total	Amount	% of Total	(Decrease)
Loans by type:					