NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORP /DC/
Form 10-K
August 30, 2010

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, 2010

OR

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

Commission File Number 1-7102

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

(Exact name of registrant as specified in its charter)

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

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

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

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

Title of each class	Name of each exchange on which registered	Title of each class	Name of each exchange on which registered
7.20% Collateral Trust Bonds, due 2015	NYSE	6.75% Subordinated Notes, due 2043	NYSE
6.55% Collateral Trust	NYSE	6.10% Subordinated Notes,	NYSE

Bonds, due 2018		due 2044	
7.35% Collateral Trust Bonds, due 2026	NYSE	5.95% Subordinated Notes, due 2045	NYSE

Securities registered pursuant to Section 12(g) of the Act: None

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) 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, 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. (Check one):

Large accelerated filer ¨   Accelerated filer ¨   Non-accelerated filer x   Smaller reporting company ¨

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

The Registrant is a tax-exempt cooperative and consequently is unable to issue any equity capital stock.

TABLE OF CONTENTS

Part No.	Item No.			Page
I.	1.	Business		1
			General	1
			Our Business Development	2
			Our Loan Programs	3
			Guarantee Programs	10
			Our Lending Competition	12
			Our Lending Regulation	14
			Our Members	14
			Corporate Governance	16
			Rural Electric Industry	18
			Rural Telecommunications Industry	21
			Disaster Recovery	22
			Tax Status	23
			Allocation and Retirement of Patronage Capital	23
			Investment Policy	24
			Employees	25
	1A.	Risk Factors		25
	1B.	Unresolved Staff Comments		28
	2.	Properties		28
	3.	Legal Proceedings		29
	4.	[Removed and Reserved]		29
II.	5.	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities		30
	6.	Selected Financial Data		30
	7.	Management's Discussion and Analysis of Financial Condition and Results of Operations		31
			Executive Summary	31
			Critical Accounting Policies and Estimates	33
			New Accounting Pronouncements	37
			Results of Operations	37
			Ratio of Earnings to Fixed Charges	45
			Financial Condition	45
			Off-Balance Sheet Obligations	55
			Liquidity and Capital Resources	56
			Market Risk	60
			Non-GAAP Financial Measures	65
	7A.	Quantitative and Qualitative Disclosures About Market Risk		69
	8.	Financial Statements and Supplementary Data		69
	9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure		70
	9A(T).	Controls and Procedures		70
	9B.	Other Information		71
III.	10.	Directors, Executive Officers and Corporate Governance		72
	11.	Executive Compensation		80

	12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	90
	13.	Certain Relationships and Related Transactions, and Director Independence	91
	14.	Principal Accounting Fees and Services	92
IV.	15.	Exhibits, Financial Statement Schedules	94
		Signatures	98

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Form 10-K contains forward-looking statements defined by the Securities Act of 1933, as amended, and the Exchange Act of 1934, as amended. Forward-looking statements, which are based on certain assumptions and describe our future plans, strategies and expectations, are generally identified by our use of words such as “intend,” “plan,” “may,” “should,” “will,” “project,” “estimate,” “anticipate,” “believe,” “expect,” “continue,” “potential,” “opportunity,” and si expressions, whether in the negative or affirmative. All statements about future expectations or projections, including statements about loan volume, the adequacy of the loan loss allowance, net income growth, leverage and debt to equity ratios, borrower financial performance, impaired loans, and sources and uses of liquidity, are forward-looking statements. Although we believe that the expectations reflected in our forward-looking statements are based on reasonable assumptions, actual results and performance could materially differ. Factors that could cause future results to vary from current expectations include, but are not limited to, general economic conditions, legislative changes, governmental monetary and fiscal policies, changes in tax policies, changes in interest rates, demand for our loan products, lending competition, changes in the quality or composition of our loan and investment portfolios, changes in accounting principles, policies or guidelines, changes in our ability to access external financing, valuations of collateral supporting impaired loans, non-performance of counterparties to our derivative agreements 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 in this section should be read 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 and Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations.

PART I

Item 1. Business.

General

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. 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 solely of not-for-profit entities or subsidiaries or affiliates of not-for-profit entities. CFC is exempt from federal income taxes under Section 501(c)(4) of the Internal Revenue Code. As a member-owned cooperative, CFC has no publicly-held equity securities outstanding. CFC funds its activities primarily through a combination of publicly and privately-held debt securities and member investments. CFC’s objective is to offer its members cost-based financial products and services consistent with sound financial management and is not to maximize net income. As described under Allocation and Retirement of Patronage Capital on page 23, CFC allocates its net earnings, which consist of net income excluding certain non-cash accounting effects, annually to a cooperative educational fund, a members’ capital reserve and to members based on each member’s patronage of its loan programs during the year.

For financial statement purposes, CFC's results of operations and financial condition are consolidated with and include Rural Telephone Finance Cooperative ("RTFC") and National Cooperative Services Corporation ("NCSC"). Unless stated otherwise, references to "we," "our," or "us" relate to the consolidation of CFC, RTFC, NCSC and certain entities created and controlled by CFC to hold foreclosed assets and to accommodate loan securitization transactions. The operations for CFC, RTFC and NCSC are reported as separate segments. See Note 16, Segment Information, to the consolidated financial statements for further information related to the amount of revenues, net profit or loss and total assets for each of our segments.

Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, are available, free of charge, at www.nrucfc.coop (under the link "Investor Relations/Financial Reporting") as soon as reasonably practicable after they are electronically filed with or furnished to the SEC. These reports are also available free of charge on the SEC website at www.sec.gov. Information posted on our website is not incorporated by reference into this Form 10-K.

RTFC is a cooperative association originally incorporated in South Dakota in 1987 and reincorporated as a member-owned cooperative association in the District of Columbia in 2005. RTFC's principal purpose is to provide and arrange financing for its rural telecommunications members and their affiliates. RTFC's membership consists of a combination of not-for-profit entities and for-profit entities. CFC is the sole lender to and manages the lending activities of RTFC through a long-term management agreement. Under a guarantee agreement, RTFC pays CFC a fee, and in exchange, 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 patronage-sourced net earnings allocated to its patrons, as permitted under Subchapter T of the Internal Revenue Code.

NCSC was incorporated in 1981 in the District of Columbia as a member-owned cooperative association. The principal purpose of NCSC is to provide financing to members of CFC and the for-profit and non-profit entities that are owned, operated or controlled by, or provide substantial benefit to Class A, B and C members of CFC (see page 15 for a description of member classes). 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 activities of NCSC through a management agreement that is automatically renewable on an annual basis unless terminated by either party. Under a guarantee agreement, NCSC pays CFC a fee, and in exchange, CFC reimburses NCSC for loan losses. NCSC is headquartered with CFC in Herndon, Virginia. NCSC is a taxable cooperative, which to date, has not allocated its patronage sourced net earnings to members, thus NCSC pays income tax on the full amount of its net income.

Our Business Development

Our business strategy and policies are set by our Board of Directors and, in general, may be amended or revised from time to time by the Board of Directors. Over the past five years, we have undertaken the following initiatives as a result of the strategic planning of our Board of Directors: (i) focus on electric lending while strategically decreasing telecommunications exposures, (ii) enhance credit risk management, (iii) obtain and diversify sources of funding to meet our capital needs (iv) enhance market risk management and (v) increase and retain for longer periods equity investments by our members.

Focus on Electric Lending

We focused on lending to our electric systems while strategically decreasing our telecommunications exposure through RTFC. CFC's primary focus is lending to its core distribution and power supply members that represent 89 percent of the outstanding loan portfolio at May 31, 2010. RTFC's core client base is small and medium-sized, locally-owned and operated telecommunications providers. RTFC provides the majority of its loans for local exchange carrier infrastructure. In response to the fast pace of technological change, to increasing competition among telecommunication providers and to potential changes to laws, regulations and the Universal Service Fund, over the course of the last five years RTFC shortened tenors and became more selective as to the companies it finances. An adequate supply of federal financing has been, and continues to be, available to the rural telecommunications industry through RUS and the Department of Commerce. Because of mergers and consolidations throughout the telecommunications industry in recent years and borrowers' refinancing opportunities in the capital markets, RTFC exited several transactions. As a result, RTFC's portfolio decreased by 44 percent over the last five years and is 69 percent below its peak fiscal year-end level of $5,325 million reached at May 31, 2001.

Enhance Credit Risk Management

We believe our staff has consistently maintained a strong understanding of the credit quality of our members and the rural electric and telecommunications industry. In fiscal year 2002, we took steps to enhance and formalize our monitoring of credit quality through the establishment of a Credit Risk Management group. In conjunction with establishing credit policies and overseeing our internal risk rating system, the Credit Risk Management group facilitates the activities of our internal credit review process and our internal multi-department Corporate Credit

Committee. This committee performs a vital role in maintaining a balance between the credit needs of our members and the requirements for sound credit quality of our loan and guarantee portfolio. The Corporate Credit Committee monitors lending policies and practices and reviews extensions of credits requiring special attention. The Corporate Credit Committee also monitors selected rating changes, analyzes rating integrity, and works to improve our internal risk rating system. As part of our financing credit culture, we imposed additional requirements on single obligors and increased our participation in loan syndications to effectively manage portfolio risk related to credit concentrations. Our internal risk rating system and credit extension practices are reviewed each year by external consultants who evaluate the integrity of specific risk ratings and provide recommendations to management and the Board of Directors.

Obtain Diverse Funding Sources

We continued to pursue diverse sources of funding other than the capital markets. In addition to debt security offerings of collateral trust bonds, medium-term notes and the sale of commercial paper, we utilized funding available under the Guaranteed Underwriter program of the U.S. Department of Agriculture, as well as note purchase agreements and whole loan sale programs with the Federal Agricultural Mortgage Corporation to meet our capital needs. In June 2005, we entered into the first of three bond purchase agreements under the Guaranteed Underwriter program of the U.S. Department of Agriculture which supports the Rural Economic Development Loan and Grant program and provides guarantees to the Federal Financing Bank. The guarantee fees paid to the government by CFC in connection with these borrowings are used to fund economic development programs in the rural areas served by electric cooperatives. Beginning in December 2008, we entered into four note purchase agreements with the Federal Agricultural Mortgage Corporation. The note purchase agreements allow us to borrow, repay and re-borrow funds up to amounts specified in the agreements at any time or from time to time as market conditions permit. We may select a fixed rate or a variable rate at the time of each advance. We also developed a program to sell member systems' distribution and power supply loans to the Federal Agricultural Mortgage Corporation as an additional form of liquidity. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources for additional information regarding our funding sources.

Enhance Market Risk Management
In fiscal year 2009, we took steps to enhance and formalize the monitoring of our funding activities through the creation of an Asset Liability Committee. Our Asset Liability Committee monitors our management of interest rate, credit and liquidity risks to ensure consistent access to funding that is in alignment with our strategic plan. The committee ensures adequate liquidity while managing the relationship of our assets to our liabilities and, as a result, our spread between interest income and interest expense. Functional responsibilities of this committee include reviewing pricing and other funding decisions, investment decisions and trends in funding alternatives and risk exposure. Performance results and budget deviations are also reviewed. If necessary, the organization's asset-liability strategy is reviewed for modification to react to the current market environment. At least quarterly, the Asset Liability Committee reviews a complete interest rate risk analysis, reviews proposed modifications, if any, to our interest rate risk management strategy and considers adopting strategy changes. See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations- Market Risk for additional information regarding our market risk management.

Increase Member Investments and Equity Retention
We developed a corporate initiative to increase the investments of our members and our equity retention. The two primary components of this initiative are: (1) our offering of member capital securities, a 35-year unsecured and subordinate voluntary debt investment, to our members beginning in November 2008 and (2) our adjustment of CFC's patronage capital retirement practices in June 2009.

Member capital securities are unsecured obligations and are subordinate to all of our existing and future senior indebtedness and all of our existing and future subordinated indebtedness that may be held by or transferred to non-members, but rank on a parity to all other member subordinated certificates. Member capital securities mature 35 years from the date of issuance. Member capital securities are callable at par by CFC starting five years from the date of issuance and anytime thereafter. At May 31, 2010, $398 million of member capital securities were issued and outstanding.

In June 2009, CFC revised its guidelines related to the timing and amount of CFC's patronage capital retirements in order to further strengthen its equity position. At the end of each fiscal year, CFC's Board of Directors allocates its net earnings to members in the form of patronage capital and to board-approved reserves. CFC bases the amount of net earnings allocated to each member on the members' patronage of CFC's lending programs during the year. CFC's Board of Directors historically votes to retire a portion of the prior year's patronage capital allocation. Under the current guidelines, CFC retires 50 percent of its prior year's allocated net earnings and holds the remaining 50 percent for 25 years. CFC's practice prior to June 2009 was to retire 70 percent of its prior year's allocated net earnings and hold the remaining 30 percent for 15 years. CFC's Board of Directors has the authority to change the patronage capital retirement amount and timing of payout at its discretion. While District of Columbia cooperative law requires cooperatives to allocate net earnings to certain reserves and to their patrons, there is no requirement to retire patronage capital.

Our Loan Programs

CFC lends to its members and associates; RTFC lends to its members, organizations affiliated with its members and its associates; and NCSC lends to members of CFC and entities that are owned, controlled or operated by or provide substantial benefit to Class A, B and C members of CFC. The loans of CFC, RTFC and NCSC generally provide that an event of default has occurred if there is any material adverse change in the business or condition, financial or otherwise, of the borrower. Our loan standards are generally comparable to those of RUS, and most members significantly exceed the financial tests set by both RUS and CFC.

CFC Loan Programs

Long-Term Loans

CFC’s long-term loans generally have the following characteristics:

- terms of up to 35 years on a senior secured basis;
- amortizing or bullet maturity loans with serial payment structures;
- the property plant and equipment financed by and securing the long term loan has a useful life equal to or in excess of the loan maturity;
- flexibility for the borrower to select a fixed interest rate for periods of one to 35 years or a variable rate; and
- the ability for the borrower to select various tranches with either a fixed or variable interest rate for each tranche.

Members may select a fixed or a variable interest rate at the time of each advance on long-term loan facilities. When selecting a fixed rate, the member has the option to choose a fixed rate for a term of one year through the final maturity of the loan. When the selected fixed interest rate term expires, the borrower may select another fixed rate for a term of one year through the loan maturity or the current variable rate. Electric long-term fixed rates are set daily for new loan advances and loans that reprice. The long-term variable rate is set on the first day of each month. The fixed rate on each loan is determined on the day the loan is advanced or repriced based on the term selected.

To be in compliance with the covenants in the loan agreement and eligible for loan advances, distribution systems generally must maintain an average modified debt service coverage ratio, as defined in the loan agreement, of 1.35 or greater. Similarly, power supply systems generally must maintain an average modified debt service coverage ratio, as defined in the loan agreement, of 1.0 or greater. CFC may make long-term loans to distribution and power supply systems, on a case-by-case basis, that do not meet these general criteria.

Short-Term Loans

Short-term loans are generally unsecured lines of credit. Line of credit loans are generally advanced at variable interest rates. These variable interest rates may be set on the first day of each month or mid-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. Line of credit loans are also made available when a member either receives RUS approval to obtain interim financing or submits a loan application that is pending approval from RUS (sometimes referred to as “bridge loans”). Advances under these interim facilities must be repaid with advances from RUS long-term loans.

Short-Term Syndicated Loans

A syndicated loan is typically a large financing offered by a group of lenders who work together to provide funds for a single borrower. Syndicated loans are generally unsecured, floating-rate loans that can be provided on a revolving or term basis for tenors that range from several months to several years. Syndicated financing is arranged for members on a case-by-case basis. CFC may act as lead lender, arranger and administrative agent for the syndicated facilities. CFC will make its best efforts to syndicate the loan requirements of members in good standing. The success of such efforts will depend on the financial position and credit quality of the member as well as market conditions.

RTFC Loan Programs

At May 31, 2010 and 2009, 88 percent of RTFC loans were outstanding to rural local exchange carriers. Most of these rural local exchange carriers evolved from solely being voice service providers to being providers of voice, data and, oftentimes, video and wireless services. Rural local exchange carriers are generally 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 support the operations of the rural local exchange carriers and are owned, operated or controlled by rural local exchange carriers. Many such loans are supported by payment guarantees from the sponsoring rural local exchange carriers.

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.

RTFC's long-term loans generally have the following characteristics:

- terms not exceeding 10 years on a senior secured or senior unsecured basis;
- the property plant and equipment financed by and securing the long-term loan has a useful life equal to or in excess of the loan maturity;
- flexibility for the borrower to select a fixed interest rate for periods from one year to the final loan maturity or a variable interest rate; and
- the ability for the borrower to select various tranches with either a fixed or variable interest rate for each tranche.

When a selected fixed interest rate term expires, the borrower may select another fixed-rate term or a variable rate. 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. The long-term variable rate is set on the first day of each month.

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 and an annual times interest earned ratio ("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 debt service coverage ratio of 1.25.

Short-Term Loans

Short-term loans are generally unsecured lines of credit. These line of credit loans are designed primarily to assist borrowers with liquidity and cash management. RTFC provides line of credit loans to telecommunications systems for periods generally not to exceed five years. These line of credit loans are typically revolving facilities and generally require the borrower to pay off the principal balance for five consecutive business days at least once during each 12-month period.

Interim financing line of credit loans are also made available to telecommunications systems when a member either receives RUS approval to obtain interim financing or when a loan application is pending approval from RUS. These loans are for terms up to 24 months, and the borrower must repay the RTFC loans with advances from the RUS long-term loans.

NCSC Loan Programs

NCSC makes long-term and short-term loans to members of CFC and entities that are owned, controlled or operated by or provide substantial benefit to Class A, B and C members of CFC, some of which may be NCSC members. Membership in NCSC is limited to organizations that are Class A members of CFC, or eligible for such membership, and CFC. The loans to the affiliated organizations may provide a guarantee of repayment to NCSC from the CFC member cooperative with which it is affiliated.

Long-Term Loans

NCSC's long-term loans generally have the following characteristics:

- terms of up to 35 years on a senior secured or unsecured basis;
- amortizing or bullet maturity loans with serial payment structures;
- the property plant and equipment financed by and securing the long-term loan has a useful life equal to or in excess of the loan maturity;
- flexibility for the borrower to select a fixed interest rate for periods of one to 35 years or a variable rate; and
- the ability for the borrower to select various tranches with either a fixed or variable interest rate for each tranche.

NCSC allows members to select a fixed interest rate or a variable interest at the time of each advance on long-term loan facilities. When selecting a fixed rate the member has the option to choose a fixed rate for a term of one year through the final maturity of the loan. When the selected fixed interest rate term expires, the borrower may select another fixed rate for a term of one year through the loan maturity or the current variable rate. NCSC sets long-term fixed rates daily for new loan advances and loans that reprice. The long-term variable rate is set on the first day of each month. The fixed rate on a loan is determined on the day the loan is advanced or repriced based on the term selected.

Short-Term Loans

Short-term loans may be provided on a secured or unsecured basis. Line of credit loans are generally advanced at variable interest rates. These variable interest rates may be set on the first day of each month or mid-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.

Interest Rates on Loans
As a member-owned cooperative finance company, we are a cost-based lender. Our interest rates are set primarily based on our cost of funding, general and administrative expenses, loan loss provision and a reasonable level of earnings. Various standardized discounts reduce the stated interest rates for Class A and Class B borrowers meeting certain criteria related to business type, performance, volume and whether they borrow only from us.

The table below shows the weighted-average loans outstanding to borrowers and the weighted-average interest rate earned by loan type and by segment during fiscal years ended May 31:

	2010		2009	
	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	$15,240,370	5.81%	$14,710,754	5.93%
Long-term variable-rate loans	1,577,217	4.78	1,654,355	5.34
Loans guaranteed by RUS	240,328	4.98	246,789	5.09
Short-term loans	1,660,102	3.40	2,034,736	4.05
Non-performing loans	523,813	-	495,014	-
Restructured loans	521,570	0.61	556,892	0.63
Total loans	$19,763,400	5.22	$19,698,540	5.38
Total by segment:				
CFC (2)	$17,681,663	5.29%	$17,579,888	5.43%
RTFC (3)	1,718,100	4.21	1,693,123	4.50
NCSC	363,637	6.61	425,529	6.59
Total	$19,763,400	5.22	$19,698,540	5.38

(1) Loans are classified as long-term or short-term based on their original maturity.
(2) Includes $475 million and $504 million of restructured loans on non-accrual status during the years ended May 31, 2010 and 2009, respectively.
(3) Includes $524 million and $495 million of non-performing loans on non-accrual status during the years ended May 31, 2010 and 2009, respectively.

Credit Policies, Process and Monitoring
CFC’s Board of Directors approves loan policies and established a loan committee of the Board that is comprised of no fewer than 10 directors. The loan committee of the Board is authorized to approve loans based on levels of credit exposure and risk ratings set forth in loan policies. In addition, the loan committee of the Board approves all exceptions to credit limitations and approves financing arrangements involving credits to entities where a CFC director is either a director or officer of a member. CFC’s Board of Directors delegates certain loan approval authority to management. The decision to write off all or a portion of any loan is reserved for the full Board of Directors. CFC’s Credit Risk Management group is responsible for the administration of CFC’s internal risk rating system, and, along with an internal multi-department Corporate Credit Committee, monitors lending policies and practices. The Credit Risk Management group, on an ongoing basis, and the Corporate Credit Committee, on a quarterly basis, monitor all past due, non-accrual and restructured facilities that are not performing under their original terms. The Credit Risk Management group prepares reports on such matters to the CFC Board of Directors.

The Boards of Directors for RTFC and NCSC set the lending policies for those companies. Under the terms of the credit agreements between RTFC and NCSC, respectively, and CFC, any changes to RTFC or NCSC lending criteria or approval processes are subject to approval by CFC. CFC's lending staff, Credit Risk Management group and Corporate Credit Committee provide the same credit approval and monitoring functions for RTFC and NCSC as they do for CFC as part of CFC’s management agreements with RTFC and NCSC.

Credit Process

All loans are underwritten by CFC lending staff. Distribution loans generally have standard terms and conditions while generation and transmission loans and loans to associates may be more customized. All loans are approved according to an internal credit approval matrix, with approval authority escalating based on size and risk from lending staff and management, to the Corporate Credit Committee, and to CFC’s Board of Directors if required by Board policy.

Monitoring Process
Annually, members submit to us standard industry financial and statistical reports and covenant compliance certificates, and borrowers are required to provide us with audited financial statements. Risk ratings are updated annually or more often if there are credit events. The Corporate Credit Committee reviews extensions of credits requiring special attention. The credit process is audited annually by internal audit staff. In addition, an independent third party performs an annual credit review of a majority of loans in the portfolio, reviews the accuracy of our internal risk rating system, monitors credit extension practices and reports to management. The results of the audit and independent credit review are communicated to CFC's Board of Directors along with any recommendations for improvement.

Loan Portfolio Performance
At May 31, 2010, there were two borrowers not current with regard to their required loan payments. Our members provide essential services and are insulated to some extent from the problems other companies may experience with regard to collection of amounts due during periods of recession. As a result, the difficult economic conditions experienced in recent years have not resulted in a significant rise in delinquencies or defaults in our members' receivables. For calendar year 2009, our member systems did not report a significant increase in late payments of utility bills from their member rate-payers or write-offs. Since the start of the financial crisis in September 2008, only one borrower has gone into payment default.

During the three-year period ended May 31, 2010, only five borrowers were in default of loan payments, four of which were telecommunications borrowers. During the past three years, we wrote off $23 million related to three of the four telecommunications borrowers, including $17 million for the largest borrower during fiscal year 2008 and two smaller write-offs totaling $6 million in fiscal year 2009. There were no loan write-offs in fiscal year 2010. The remaining two borrowers had a combined loan balance outstanding of $561 million classified as non-performing loans at May 31, 2010. Non-performing loans totaling $536 million were outstanding to Innovative Communication Corporation ("ICC") at May 31, 2010. ICC has not made payments to us since 2005, and we expect to acquire its assets during fiscal year 2011 as a result of bankruptcy proceedings. Non-performing loans to the other borrower totaling $25 million at May 31, 2010 were put on non-accrual status in May 2010 and the default is still in the process of being resolved. We had no other loans for which payments were more than 30 days delinquent at May 31, 2010. All loans classified as restructured are making payments as scheduled by the restructured agreements. See Note 15, Restructured/Non-performing Loans and Contingencies, for additional information on our restructured and non-performing loans.

Our total loans outstanding increased by $1,210 million over the last three years ended May 31, 2010. The total loans outstanding increased by $899 million and $1,161 million during fiscal years 2008 and 2009, respectively, and decreased by $850 million during fiscal year 2010. The $850 million decrease in fiscal year 2010 was due to a $776 million decrease in electric loans, an $8 million decrease in RTFC loans and a $66 million decrease in NCSC loans. The primary reasons for the decline to the electric loan portfolio were the approximately $460 million of repayments from power supply bridge loans with loan funds from RUS as anticipated, the general decline in construction of distribution infrastructure due to the economic downturn, the lower use of lines of credit from distribution members and the sale of $107 million in existing distribution loans to the Federal Agricultural Mortgage Corporation during the period. We currently anticipate our electric loan portfolio to decrease slightly over the next 12 months as a result of continued loan sales. Due to the expected acquisition of telecommunication assets of ICC as foreclosed assets, planned prepayments by telecommunications borrowers, increased availability of government financing for rural broadband and our strategic focus on electric lending, we expect a significant decrease to our telecommunications loan portfolio in fiscal year 2011.

Since we are limited to doing business with our members and associates, the growth in our loan portfolio is dependent on our members' need for capital funding and the options available to them to obtain such funding. Thus, it is very difficult to predict, with any certainty, the amount of new loan advances that will occur over the next 12 to 18 months. This is especially true with the balance of line of credit loans which are used by our members to manage liquidity or for interim financing in anticipation of obtaining long-term RUS loans. Oftentimes these interim financing lines of credit carry relatively large balances.

Credit Concentration

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

(dollar amounts in thousands) State/Territory	2010	2009	2008	State/Territory	2010	2009	2008
Alabama	$ 400,037	$ 430,065	$ 414,961	Montana	$ 128,037	$ 128,563	$ 133,655
Alaska	350,522	340,861	371,768	Nebraska	13,420	13,844	18,756
American Samoa	470	489	769	Nevada	158,137	171,754	155,625
Arizona	239,186	246,171	206,558	New Hampshire	120,968	132,741	143,417
Arkansas	558,493	615,429	522,018	New Jersey	18,090	18,806	17,747
California	27,588	37,270	25,968	New Mexico	27,791	32,254	36,636
Colorado	937,982	944,938	942,179	New York	16,560	14,523	19,735
Connecticut	200,000	200,000	200,000	North Carolina	392,872	468,240	487,249
Delaware	27,223	36,253	37,950	North Dakota	113,668	68,758	69,120
District of Columbia	9,069	9,298	9,514	Ohio	367,607	444,565	455,491
Florida	586,228	651,564	677,365	Oklahoma	520,302	500,189	483,623
Georgia	1,473,464	1,584,178	1,567,108	Oregon	300,871	303,926	303,166
Hawaii	9,229	6,443	6,804	Pennsylvania	379,504	375,549	357,337
Idaho	154,996	158,013	157,703	South Carolina	435,156	464,125	484,733
Illinois	728,541	661,632	600,571	South Dakota	153,815	142,582	147,916
Indiana	637,271	839,473	530,008	Tennessee	68,158	76,553	107,575
Iowa	557,553	493,722	465,056	Texas	3,114,889	3,332,283	3,044,117
Kansas	822,599	801,389	878,630	Utah	569,537	561,050	570,971
Kentucky	285,166	472,693	363,720	Vermont	66,049	79,131	74,957
Louisiana	334,339	388,490	333,984	Virgin Islands	536,026	523,758	491,706
Maine	11,416	4,093	4,566	Virginia	357,377	201,798	235,916
Maryland	223,779	216,468	224,754	Washington	182,471	161,099	122,674
Michigan	218,037	279,490	265,116	West Virginia	2,921	2,341	6,109
Minnesota	785,774	792,863	655,576	Wisconsin	418,361	418,898	384,748
Mississippi	400,138	422,625	395,423	Wyoming	115,759	121,011	133,087
Missouri	780,959	795,956	682,860	Total	$19,338,405	$20,188,207	$19,026,995

The service territories of our electric and telecommunications members and associates are located throughout the United States and its territories, including 49 states, the District of Columbia, American Samoa and Guam. Our members provide essential electric and telecommunications services to customers in rural areas covering approximately 70 percent of the land mass of the contiguous United States. Each system is separate from other systems and there is significant variance in the size of each system, thus each system's capital requirements vary significantly. At May 31, 2010, 2009 and 2008, loans outstanding to any one borrower did not exceed 2.7 percent, 2.6 percent and 2.8 percent, respectively, of total loans outstanding. At May 31, 2010, 2009 and 2008, the top 10 borrowers held approximately 18 percent of total loans outstanding.

At May 31, 2010, 2009 and 2008, the largest concentration of loans to borrowers in any one state was in Texas, which had approximately 16 percent, 17 percent and 16 percent, respectively, of total loans outstanding. No other state had a loan concentration exceeding 8 percent at May 31, 2010 and 2009 and 9 percent at May 31, 2008. Two primary factors contributed to Texas having the largest percentage of total loans outstanding compared to other states at May 31, 2010:

- Texas has the largest number of total borrowers compared to other states (see table on page 15); and
- Texas has the largest number of power supply systems (10 of our 68 power supply systems), which require significantly more capital than distribution systems and telecommunications systems.

CFC, RTFC and NCSC each have policies limiting the amount of credit that can be extended to individual borrowers or a controlled group of borrowers. The credit limitation policies cap the total exposure and unsecured exposure to the borrower based on an assessment of the borrower's risk profile, the type of facility and our internal risk rating system. As a member-owned cooperative lender, we balance the needs of our members and the risk associated with concentrations of credit exposure. The respective boards of directors must approve new credit requests from borrowers with total exposure or unsecured exposure in excess of the limits in the policies. Management may use syndicated credit arrangements to minimize credit concentrations.

Total exposure, as defined by the policies, generally includes the following:

- loans outstanding, excluding loans guaranteed by RUS;
- our guarantees of the borrower's obligations;
- unadvanced loan commitments;
- borrower guarantees to us of another borrower's debt; and
- any other indebtedness with us, unless guaranteed by the U.S. government.

The calculation of total exposure includes facilities that might not be drawn by the borrower, such as lines of credit and loan commitments for projects that may be delayed or eventually cancelled.

Unadvanced Commitments

At May 31, 2010, 2009 and 2008, we had the following amount of unadvanced commitments on loans to our members.

(dollar amounts in thousands)	2010	% of Total	2009	% of Total	2008	% of Total
Long-term	$ 5,154,990	36%	$ 5,609,977	41%	$ 5,976,032	44%
Short-term	9,039,448	64	7,941,146	59	7,597,712	56
Total	$14,194,438	100%	$ 13,551,123	100%	$13,573,744	100%
CFC	$13,248,732	93%	$ 12,804,021	95%	$12,698,199	94%
RTFC	441,719	3	457,022	3	562,389	4
NCSC	503,987	4	290,080	2	313,156	2
Total	$14,194,438	100%	$ 13,551,123	100%	$13,573,744	100%

Prior to making an advance under the majority of our unadvanced commitments, we confirm there has been no material adverse change in the borrower's business or financial condition since we approved the loan. It is our experience that unadvanced commitments are usually not fully drawn, and that borrowings by members occur in multiple transactions over an extended period of time. We believe these practices will continue for the following reasons:

- electric cooperatives typically execute loan contracts to cover multi-year work plans and, as such, it is expected that advances on such loans will occur over a multi-year period;
- electric cooperatives generate a significant amount of cash from the collection of invoices from their customers, so they usually do not need to draw down on loan commitments for operating cash flows;
- we generally do not charge our members a fee on the amount of the unadvanced commitment;
- long-term unadvanced commitments generally expire within five years of the first advance on a loan; and
- the majority of the short-term unadvanced commitments provide backup liquidity to our borrowers; therefore, we do not anticipate funding most of these commitments.

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. Generally, a borrower may convert its long-term loan from a fixed rate to another fixed rate or to a variable rate at any time in exchange for a fee plus a make-whole premium, if applicable, based on current loan policies.

Prepayment of Loans

Generally, borrowers may prepay long-term fixed-rate loans at any time, subject to a prepayment fee and a make-whole premium, if applicable. Long-term variable-rate loans may be prepaid at any time, subject to a prepayment fee, unless specifically waived in the loan agreement. Line of credit loans may be prepaid at any time without a fee, unless the interest rate on the loan is fixed or based on a LIBOR index.

Loan Security

Long-term loans are typically senior secured on parity with other secured lenders (primarily RUS), if any, by all assets and revenues of the borrower, though utility mortgages are subject to standard liens such as those related to taxes, worker's compensation awards, mechanics' and similar liens, rights-of-way, governmental rights and judgment liens. We are able to obtain liens on parity with liens for the benefit of RUS even where the RUS loan was made earlier in time than ours because RUS's form of mortgage expressly provides for other lenders such as us to have parity where the borrower satisfies certain conditions or obtains a written lien accommodation from RUS. When we make loans to borrowers that have existing loans from RUS, we generally require those borrowers either to obtain such a lien accommodation or to satisfy the conditions necessary for our loan to be secured on parity under the mortgage with the loan from RUS.

Our short-term loans are generally unsecured lines of credit. Short-term loans are generally to provide a source of working capital, and thus it is market practice that short-term loans are not secured.

The following tables summarize our secured and unsecured loans outstanding by loan type and by segment at May 31:

(dollar amounts in thousands)	2010				2009			
Total by loan type:	Secured	%	Unsecured	%	Secured	%	Unsecured	%
Long-term fixed-rate loans	$ 14,799,859}	96 %	$ 613,128}	4 %	$ 14,044,469	96%	$ 557,896	4 %
Long-term variable-rate loans	1,994,664}	95	94,165}	5	2,835,451	87	408,265	13
Loans guaranteed by RUS	237,356}	100	-}	-	243,997	100	-	-
Short-term loans	265,427}	17	1,333,806}	83	233,179	11	1,864,950	89
Total loans	$ 17,297,306}	89	$ 2,041,099}	11	$ 17,357,096	86	$ 2,831,111	14
Total by segment:								
CFC	$ 15,585,788}	90 %	$ 1,729,241}	10%	$ 15,562,761	86%	$ 2,528,572	14%
RTFC	1,429,982}	86	241,911}	14	1,443,395	86	236,759	14
NCSC	281,536}	80	69,947}	20	350,940	84	65,780	16
Total loans	$ 17,297,306}	89	$ 2,041,099}	11	$ 17,357,096	86	$ 2,831,111	14

Guarantee Programs

When we guarantee debt obligations for our members, we use the same credit policies and monitoring procedures for guarantees as for loans and commitments. If a member system defaults in its obligation to pay debt service, then we are obligated to pay any required amounts under our guarantees. Meeting our guarantee obligations satisfies the underlying obligation of our member systems and prevents the exercise of remedies based upon a payment default by a member system. The following table provides a breakout of guarantees outstanding by type and segment at May 31:

(dollar amounts in thousands)	2010	2009
Long-term tax-exempt bonds	$ 601,625}	$ 644,540
Indemnifications of tax benefit transfers	69,982}	81,574
Letters of credit	380,076}	450,659
Other guarantees	119,426}	98,682
Total	$ 1,171,109}	$ 1,275,455

(dollar amounts in thousands)				
CFC:	2010		2009	
Distribution	$ 221,903}	19%	$ 264,084	21%
Power supply	884,828}	75	945,624	74
Statewide and associate	22,032}	2	23,625	2
CFC Total	1,128,763}	96	1,233,333	97
RTFC	636}	-	500	-
NCSC	41,710}	4	41,622	3
Total	$ 1,171,109}	100%	$ 1,275,455	100%

Guarantees of Long-Term Tax-Exempt Bonds

We guarantee debt issued for our members' construction or acquisition of pollution control, solid waste disposal, industrial development and electric distribution facilities. Governmental authorities issue such debt on a non-recourse basis to the government authority 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 we guarantee may include short- and long-term obligations.

If a system defaults for failure to make the debt payments, we are obligated to pay, after available debt service reserve funds have been exhausted, scheduled debt service under our guarantee. Such payment will prevent the occurrence of an event of default that would otherwise permit acceleration of the bond issue. The system is required to repay, on demand, any amount that we advance pursuant to our guarantee. This repayment obligation is typically senior secured on a parity 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, we may not exercise remedies for up to two years following default. However, if the debt is accelerated under the common mortgage because of a determination that the related interest is not tax-exempt, the system's obligation to reimburse us for any guarantee payments will be treated as a long-term loan. The system is required to pay us initial and/or ongoing guarantee fees in connection with these transactions.

Certain guaranteed long-term debt bears interest at variable rates that are adjusted at intervals of one to 270 days, weekly, each five weeks or semi-annually to a level favorable to their resale or auction at par. If funding sources are available, the member who issued the debt may choose a fixed interest rate on the debt. When the variable rate is reset, holders of variable-rate debt have the right to tender the debt for purchase at par. In some transactions, we have committed to purchase this debt as liquidity provider if it cannot otherwise be remarketed. If we hold the securities, the cooperative pays interest to us at our short-term variable interest rate. At May 31, 2010 and 2009, we were the guarantor and liquidity provider for $549 million and $643 million, respectively, of tax-exempt bonds issued for our member cooperatives. During the year ended May 31, 2010, we were not required to purchase any tax-exempt bonds pursuant to our obligation as liquidity provider. During the year ended May 31, 2009, we purchased $72 million of these securities pursuant to our obligation as the liquidity provider. All tax-exempt bonds we held during the year had been redeemed or repurchased by third-party investors prior to May 31, 2009 with no gain or loss on the transactions.

Guarantees of Tax Benefit Transfers

We have also 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 us for any guarantee payments would be treated as a long-term loan, secured on a parity with RUS by a first lien on substantially all of 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.

Letters of Credit

In exchange for a fee, we issue 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 may be on a secured or unsecured basis. Each letter of credit 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 us within one year from the date of the draw, with interest accruing from that date at our short-term variable interest rate.

Other Guarantees

We may provide other guarantees as requested by our members. These guarantees may be made on a secured or unsecured basis with guarantee fees set to cover our general and administrative expenses, a provision for losses and a reasonable margin.

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

(dollar amounts in thousands)

State/Territory	2010	2009	2008	State/Territory	2010	2009	2008
Alabama	$198,018	$198,506	$ 72,070	Missouri	$ 61,151	$ 68,363	$ 75,102
Alaska	3,884	3,860	1,900	Montana	71	12,772	9,056
American Samoa	1	-	-	Nebraska	11	7	4
Arizona	29,967	29,869	33,745	Nevada	47,018	37,452	5,400
Arkansas	4,309	6,166	8,008	New Hampshire	26,063	24,763	32,767
California	333	6,247	6,110	New Mexico	1,025	1,036	1,048
Colorado	51,964	52,690	53,467	New York	96	113	-
Delaware	12	8	-	North Carolina	105,871	105,905	99,729
District of Columbia	14,900	16,000	17,448	North Dakota	5,197	5,825	6,474
Florida	12,058	2,851	3,725	Ohio	4,005	7,000	8,000

Georgia	27,890	23,718	26,775	Oklahoma	800	764	754
Hawaii	1,300	1,300	-	Oregon	23,452	28,511	29,034
Idaho	-	3,173	3,173	Pennsylvania	12,622	18,747	17,416
Illinois	79,854	82,927	229	South Carolina	645	506	6,300
Indiana	19	23	13	South Dakota	24	19	20
Iowa	6,269	6,961	8,271	Tennessee	3,747	3,939	1,460
Kansas	39,632	41,318	60,797	Texas	219,754	216,443	194,214
Kentucky	82,562	91,741	102,423	Utah	-	6,961	13,495
Louisiana	407	501	389	Vermont	1,100	1,350	1,250
Maine	9	4	2	Virginia	2,552	2,874	3,447
Maryland	37,048	52,078	11,725	Washington	9	19,050	19,050
Michigan	5,131	5,236	2,232	Wisconsin	452	305	320
Minnesota	1,576	1,601	3,025	Wyoming	5	4,829	13,724
Mississippi	58,296	81,143	83,549	Total	$1,171,109	$1,275,455	$1,037,140

Our Lending Competition

Electric Lending
RUS is the largest lender to electric cooperatives. Generally, RUS provides long-term secured loans. CFC offers its members financial products and services that supplement and complement those of RUS and, therefore, CFC does not consider RUS to be a competitor. CFC competes with banks to make bridge loans that are needed by electric cooperatives in anticipation of obtaining long-term funding from RUS, the portion of a loan that RUS is unable to provide, and loans to members that have elected not to borrow from RUS. For the fiscal year ending September 30, 2010, RUS is authorized to lend $100 million for hardship loans and $6,500 million for loan guarantees.

Our main competitor is CoBank, ACB, a federally chartered instrumentality of the United States that is a member of the Farm Credit System. As a government-sponsored enterprise, CoBank, ACB, has the benefit of an implied government guarantee. In addition, members may obtain funding from commercial banks or may be large enough to directly access the capital markets for funding. As a result, we are competing with the pricing and funding options the member is able to obtain from these sources. We attempt to minimize the effect of competition by offering a variety of loan options and value-added services and by leveraging the working relationship we have developed with the majority of our members.

In order to meet the unique needs of our members, we offer options including credit support in the form of letters of credit and guarantees, large transaction management and loan sales to other financial institutions. Credit products are tailored to meet specific transaction structures and are often designed to cover gaps left by other lenders, such as bridge loans to long-term financing provided by RUS. CFC also offers certain risk mitigation products and interest rate discounts on secured, long-term loans for its members that meet certain criteria, including performance, volume, collateral and equity requirements.

CFC established certain funds to benefit its members. Since 1981, CFC has set aside a portion of its annual margins in a cooperative educational fund to promote awareness and appreciation of the cooperative principles. As directed by CFC’s Board of Directors, the contributions to the funds are distributed through the electric cooperative statewide associations. Since 1986, CFC has supported its members’ efforts to protect their service territories from erosion or takeover by other utilities through assistance from the Cooperative System Integrity Fund. This program is funded through voluntary contributions from members, and amounts are distributed to applicants that establish that all or a significant portion of their consumers, services or facilities face a hostile threat of acquisition or annexation by a competing entity, or that it faces a significant threat in its ability to continue to provide electric or other energy services to customers.

CFC also offers its members additional services to enhance member operations including:

- Return net earnings to members through the retirement of patronage capital. The laws of the District of Columbia require CFC to allocate, but not retire patronage capital, however CFC maximizes members’ returns by retiring patronage capital to significantly reduce the effective cost of borrowing each year based on approval by its Board of Directors.

- CFC’s Paying Agent Service. CFC’s Paying Agent Service allows members to enhance their cash management abilities so that they can earn interest until the moment the money is needed to make loan payments, cover power bill costs or pay other ongoing costs.

- CFC’s Key Ratio Trend Analysis. CFC issues a report annually that provides members information about where their operations stand in relation to other electric systems or power suppliers of similar size, location and growth characteristics. The report provides a five-year review of rural electric trends in nine key planning areas and supports decision-making by our members’ managers and boards.

- CFC RateWatch™. This service allows members to monitor certain interest rates and alerts borrowers when fixed rates reach a maximum or minimum level specified by the borrower. Members can lock in a current interest rate for any term specified on expected future borrowings to mitigate risk, subject to certain fees. Borrowers with variable-rate loans are notified when fixed rates reach the selected level and have the option of converting at that time or of resetting CFC RateWatch at a new level. CFC offers this service free of charge.

- Regulatory support services. This service is available for members and includes, but is not limited to, assistance with rate design, expert testimony, cost-of-service analysis and strategic regulatory planning.

- Conferences, meetings, workshops and weekly periodicals. CFC produces a range of programs each year providing in-depth information and insight on utility and energy issues, financing and economic trends and outlooks, and management and leadership best practices. These conferences also provide opportunities for members' directors and employees to network with CFC staff and with their peers at other cooperatives, while simultaneously earning professional credits.

- CFC's Extranet. CFC's member website provides borrowers with a convenient way to view their loan and investment history with CFC. In addition, the website provides useful financial tools for members to analyze various aspects of their businesses. Members can also make investments in CFC and request loan advances online.

Our rural electric borrowers are all private companies, thus the overall size of the rural electric lending market cannot be determined from public information. We estimate the size of the overall rural electric lending market from the annual financial and statistical reports filed with us by our members using calendar year data. There are certain limitations with regard to our estimates of the total rural electric lending market based on the financial and statistical reports provided by our members, including the following:

- while the underlying data included in the financial and statistical reports may be audited, the preparation of the financial and statistical reports are not audited;
- in some cases, not all members provide the annual financial and statistical reports on a timely basis to be included in summarized results; and
- the financial and statistical reports do not contain the breakout of debt by lender other than RUS.

According to financial data provided to us by our 808 reporting distribution systems and 56 reporting power supply systems as of December 31, 2009, and our 809 reporting electric cooperative distribution systems and 59 reporting power supply systems as of December 31, 2008, long-term debt outstanding to CFC, RUS and other lenders in the electric cooperative industry by those entities was as follows:

(dollar amounts in thousands)	2009	2008
Total long-term debt reported by members	$ 68,766,112	$ 62,866,461
Less: long-term debt funded by RUS	(35,340,322)	(32,238,166)
Members’ non-governmental long-term debt	$ 33,425,790	$ 30,628,295

	2009	% of Total	2008	% of Total
Long-term debt funded by CFC	$15,905,971	48%	$15,605,524	51%
Long-term debt funded by other lenders	17,519,819	52	15,022,771	49
Members’ non-governmental long-term debt	$33,425,790	100%	$30,628,295	100%

Members’ long-term debt funded by CFC is further summarized by type below at December 31:

(dollar amounts in thousands)	2009	2008
Distribution	$ 12,704,496	$ 12,710,274
Power supply	3,201,475	2,895,250
Long-term debt funded by CFC	$ 15,905,971	$ 15,605,524

We are not able to specifically identify the amount of debt our members have outstanding to CoBank, ACB, from either the annual financial and statistical reports filed with us or CoBank, ACB’s public disclosure, but we believe that CoBank, ACB, is the lender other than CFC and RUS with significant long-term debt outstanding to the rural electric cooperatives.

Telecommunications Lending

In 1949, the Rural Electrification Act was amended to allow lending for the establishment and improvement of rural telecommunications service. For fiscal year 2010, RUS has $690 million in annual lending authority for rural telephone systems. To provide debt capital for rural local exchange carrier modernization, Congress created the RUS broadband loan program in 2002. Congress authorized $400 million of broadband lending authority in fiscal year 2010. In addition, the American Recovery and Reinvestment Act provides RUS with $2,500 million of budget authority for loans and grants. These funds are to be obligated by September 30, 2010. In addition to RUS, the American Recovery and Reinvestment Act authorizes the Department of Commerce's National Telecommunications and Information Administration to administer $4,700 million in budget authority to provide broadband grants for service to unserved and underserved areas.

RTFC does not compete with the RUS lending programs. Its focus is to be supplementary and complementary to RUS telecom lending. Given the increased availability of government financing for rural broadband, it is unlikely we will participate in this financing to any significant degree outside of incremental lending to existing rural local exchange carrier borrowers to provide broadband services to their customers or interim financing in connection with the federal funding programs.

As noted previously, 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 decide not to borrow from RUS or for projects not eligible for RUS financing. RTFC's competition includes commercial banks and CoBank, ACB. The competitive market for providing credit to the rural telecommunications industry is difficult to quantify. Many rural telecommunications companies are not borrowers of RUS or CoBank, ACB, and commercial banks generally do not publish information solely on their telecom portfolios. At December 31, 2009, RUS had approximately $4,200 million in loans outstanding to telecommunications borrowers. At December 31, 2009, RTFC had a total of $1,600 million in long-term loans outstanding to telecommunications borrowers.

Our Lending Regulation

CFC and RTFC are not subject to state or federal regulatory oversight or compliance with regard to lending. NCSC is required to register as a consumer lender in the states of Texas and Minnesota pursuant to NCSC's participation in EC Home Improvement, a loan program that allowed consumers to borrow funds at competitive rates for various energy efficiency-related home improvement projects. Although NCSC ceased making new EC Home Improvement loans in 2007, NCSC is required to maintain consumer lender licenses in the states of Texas and Minnesota, as there are outstanding loans to consumers in those states.

CFC, RTFC and NCSC are subject to state laws that pertain to the business conducted in each state, including but not limited to usury laws and laws governing mortgages.

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act, also known as the financial overhaul bill, was signed into law. The legislation strengthens the powers of regulators to monitor the financial industry and take action against failing companies that threaten the entire system. The law also prohibits further government bailouts of large companies and mandates numerous studies and rulemakings that may have further impact on the financial industry in future periods.

Of particular importance for our operations are the law's heightened rules for derivatives trading, including margin, capital and clearing requirements, and additional regulation and oversight of the credit rating agencies. The law calls for numerous rulemakings to implement the derivatives provisions. The extent to which we may be covered and the ultimate requirements with which we must comply are not yet clear.

Because of the Dodd-Frank Act's recent passage and the need for regulations to be issued to implement the derivatives provisions and numerous other provisions, we cannot yet determine the full effect the law will have on us.

Our Members

At May 31, 2010, after taking into consideration systems that are members of both CFC and NCSC and eliminating memberships between CFC, RTFC and NCSC, our consolidated membership totaled 1,456 members and 64 associates.

The table below presents the total number of CFC, RTFC and NCSC members and associates and borrowers by state or U.S. territory and the percentage of total loans outstanding at May 31, 2010. The percentage of total loans is based on the aggregate principal balance of the loans outstanding.

State/Territory	Number of Members (1)	Number of Borrowers	Loan Balance %	State/Territory	Number of Members (1)	Number of Borrowers	Loan Balance %
Alabama	30	24	2.07%	Missouri	64	46	4.04%
Alaska	30	16	1.81	Montana	39	28	0.66
American Samoa	1	1	-	Nebraska	39	11	0.07
Arizona	27	11	1.24	Nevada	7	4	0.82
Arkansas	30	20	2.89	New Hampshire	4	1	0.63
California	10	5	0.14	New Jersey	1	2	0.09
Colorado	39	26	4.85	New Mexico	24	14	0.14
Connecticut	1	1	1.03	New York	20	7	0.09
Delaware	1	1	0.14	North Carolina	41	32	2.03
District of Columbia	4	2	0.05	North Dakota	32	13	0.59
Florida	19	17	3.03	Ohio	42	27	1.90
Georgia	67	45	7.62	Oklahoma	49	28	2.69
Guam	2	-	-	Oregon	38	23	1.56
Hawaii	1	1	0.05	Pennsylvania	23	16	1.95
Idaho	17	14	0.80	South Carolina	37	23	2.25
Illinois	52	29	3.77	South Dakota	45	35	0.80
Indiana	53	43	3.30	Tennessee	29	23	0.35
Iowa	116	46	2.88	Texas	108	72	16.11
Kansas	49	43	4.25	Utah	11	6	2.95
Kentucky	34	24	1.48	Vermont	7	6	0.34
Louisiana	17	12	1.73	Virgin Islands	-	3	2.77
Maine	6	2	0.06	Virginia	26	15	1.85
Maryland	2	3	1.16	Washington	19	11	0.94
Massachusetts	1	-	-	West Virginia	4	2	0.02
Michigan	27	16	1.13	Wisconsin	60	27	2.16
Minnesota	73	54	4.05	Wyoming	15	13	0.60
Mississippi	27	25	2.07	Total	1,520	969	100%

(1) Includes associates.

CFC

Each of CFC's distribution and power supply members received or is eligible to receive financing from RUS. One of the criteria for eligibility for RUS financing is a "rural area" test. "Rural" is defined in the Rural Electrification Act as any area that excludes a city or town of 20,000 or more, or is an area within the service area of a borrower with an outstanding loan made under titles I though V of the Rural Electrification Act. The definition of "rural" under the act permits an area to be defined as "rural" regardless of the development of such area subsequent to the approval of the outstanding loan. As such, CFC establishes eligibility only at the time a system initially borrows from CFC, and that eligibility, as it relates to the "rural area" test, is based on a determination of whether the system borrowed or is eligible to borrow from RUS.

CFC's Bylaws provide that cooperative or nonprofit corporations, public corporations, utility districts and other public bodies that received or are eligible to receive a loan or commitment for a loan from RUS or any successor agency (as well as subsidiaries, federations or statewide and regional associations that are wholly owned or controlled by such entities) are eligible for membership. Thus, those entities that received or qualify for financing from RUS are eligible to apply for membership and subsequently borrow from CFC regardless of whether there is an outstanding loan with RUS. There are no requirements to maintain membership, although the Board has the authority to suspend a member under certain circumstances. CFC has not suspended a member to date.

CFC has the following types of members, all of which are not-for-profit entities or subsidiaries or affiliates of not-for-profit entities. All electric members provide services to both residential and commercial customers.

Class A – Distribution Systems
Cooperative or nonprofit corporations, public corporations, utility districts and other public bodies, which received or are eligible to receive a loan or commitment for a loan from RUS or any successor agency, and that are engaged or planning to engage in furnishing utility services to their members and patrons for their use as ultimate consumers. The majority of our distribution system members are consumer-owned electric cooperatives. The remaining distribution systems are governmental entities, such as public power districts, public utility districts and tribal utility authorities.

Class B – Power Supply Systems
Cooperative or nonprofit corporations that are federations of Class A members or of other Class B members, or both, or that are owned and controlled by Class A members or by other Class B members, or both, and that are engaged or planning to engage in furnishing utility services primarily to Class A members or other Class B members. Our power supply system members are member-owned electric cooperatives.

Class C – Statewide and Regional Associations
Statewide and regional associations that are wholly owned or controlled by Class A members or Class B members, or both, or that are wholly owned subsidiaries of a CFC member, and that do not furnish utility services but supply other forms of service to their members.

Class D – National Associations of Cooperatives
National associations of cooperatives that are Class A, Class B and Class C members, provided said national associations have, at the time of admission to membership in CFC, members domiciled in at least 80 percent of the states in the United States.

Associates
Nonprofit groups or entities organized on a cooperative basis that are owned, controlled or operated by Class A, B, C or D members and are engaged in or plan to engage in furnishing non-electric services primarily for the benefit of the ultimate consumers of CFC members are eligible to be an associate of CFC.

CFC Class A, B, C and D members are eligible to vote at meetings of the membership. Associates are not eligible to vote at the meetings of the membership.

At May 31, 2010, CFC's membership included:

- 832 Class A distribution systems;
- 68 Class B power supply systems;
- 66 Class C statewide and regional associations, including NCSC; and
- 1 Class D national association of cooperatives.

In addition, CFC had 60 associates, including RTFC, at May 31, 2010.

RTFC
Membership in RTFC is limited to cooperative corporations, private corporations, public corporations, nonprofit corporations, utility districts and other public bodies that are approved by the RTFC Board of Directors and are actively borrowing or are eligible to borrow from RUS, and are engaged or planning to engage directly or indirectly in furnishing telecommunications services and holding companies, subsidiaries and other organizations that are owned, operated or controlled by one or more of such entities. RTFC members are eligible to vote at each meeting of the members. Entities approved by the RTFC Board of Directors that are owned, controlled or operated by members, or entities eligible to become members, are eligible to be an associate of RTFC. Associates are not eligible to vote at meetings of the members. All RTFC members provide services to both residential and commercial customers.

At May 31, 2010, RTFC's membership included 490 members and five associates. CFC is not a member of RTFC. RTFC's members and associates consist of 194 not-for-profit entities and 301 for-profit entities at May 31, 2010.

NCSC
Membership in NCSC is limited to organizations that are Class A members of CFC, or eligible for such membership, and CFC. At May 31, 2010, NCSC's membership included 362 distribution systems and CFC. All of the NCSC distribution members are also CFC members.

Corporate Governance

CFC

Pursuant to the CFC Bylaws, there are 11 districts, 10 for the general membership and one for the Class D membership. Pursuant to its Bylaws, CFC holds an annual meeting of the members each calendar year. The Board of Directors also calls a separate meeting annually of the members in each of districts 1 to 10 for the purpose of electing a nominating committee, or electing directors or both. Each member is entitled to one vote and no more upon each matter submitted to a vote at all meetings of the members.

The business and affairs of CFC are managed by a board of up to 23 directors that exercises all of the powers of CFC except such as are by law, the Articles of Incorporation or the Bylaws conferred upon or reserved to the members. The members are only entitled to vote for the election of nominating committees and directors and the removal of directors or officers, as well as amendments to the CFC Bylaws and such other matters as the Board of Directors determines appropriate to present to the members for a vote.

Each district is represented by two board members. In districts 1 to 10, one of the two positions on the Board of Directors in each district is held by a person who is a trustee or director of a member organization within the district and the other position is held by a person who is a manager of a member organization within the district. Additionally, two directors are designated by the Class D member, the National Rural Electric Cooperative Association.

In addition to the 20 directors elected and two directors designated from the districts described above, if the Board of Directors in its discretion so determines, then there may be one additional at-large director elected to serve on the Board of Directors of CFC from time to time. The at-large director is elected by the members and serves on the Audit Committee. No person is eligible to become or remain the at-large director unless the person (i) is a trustee, director, manager, chief executive officer or chief financial officer of a member of CFC or holds a comparable position of a member of CFC, (ii) satisfies the applicable requirements of an Audit Committee financial expert and (iii) is otherwise independent in accordance with Rule 10A-3 under the Securities Exchange Act and under the New York Stock Exchange standards, which the Board of Directors adopted to evaluate the independence of our directors. Since March 2007, CFC has had such an at-large director on its Board of Directors.

Pursuant to the Bylaws, the officers of CFC include a President, Vice President, Secretary-Treasurer, and such other officers as may be determined from time to time by the Board of Directors. The officers are elected annually by the Board of Directors at the first meeting of the Board of Directors held after each annual meeting. The President, Vice President, and Secretary-Treasurer must be members of the Board of Directors.

CFC’s Board of Directors is responsible for the oversight and direction of risk management, while CFC’s management has primary responsibility for day-to-day management of the risks associated with CFC’s business. In fulfilling its risk management oversight duties, CFC’s Board of Directors receives periodic reports on business activities from executive management and from various operating groups and committees across the organization, including the Credit Risk Management group, Internal Audit group and the Corporate Compliance group, as well as the Asset Liability Committee, the Corporate Credit Committee and the Disclosure Committee. CFC’s Board of Directors also reviews CFC’s risk profile and management’s response to those risks throughout the year at its meetings.

The Board of Directors establishes CFC’s loan policies and has established a loan committee of the Board comprising no fewer than 10 directors that reviews the performance of the loan portfolio in accordance with those policies. The loan committee is authorized to approve loans based on levels of credit authorization, as well as exceptions to credit limitation tests and financing arrangements involving credits to entities where a director is either a director or officer of a member. The loan committee delegates certain loan approval authority to management. The determination to write off all or a portion of any asset is reserved for the full Board of Directors. The Credit Risk Management group, on an ongoing basis, and the Corporate Credit Committee, on a quarterly basis, monitor all past due, non-accrual and restructured facilities that are not performing under their original terms. The Credit Risk Management group prepares reports on such matters to the CFC Board of Directors. In addition, an independent third party reviews our risk rating system and credit extension practices periodically. Such third party provides recommendations to management and the Board of Directors for improvement, as well as progress on the resolution of items from prior reviews. Management is responsible for implementing the recommendations accepted by the Board of Directors.

One of the loan policies established by CFC's Board of Directors sets forth the loan guidelines and credit products established to implement the corporate purpose and program objectives of CFC. Loans and guarantees are made to Class A, B, C and D members and associates that meet applicable financial and feasibility criteria, security requirements and conditions as established for each type of loan pursuant to CFC's practices and procedures in effect at the time. A credit analysis is conducted by staff during the underwriting process for each application to determine if the applicant has the ability to meet its obligations and CFC's financial standards and if the proposed structure provides adequate security for each secured credit facility. The Board of Directors delegates to the Chief Executive Officer or the Chief Executive Officer's designee(s) the authority to implement this policy.

RTFC

The business affairs of RTFC are managed by a Board of 10 directors. Pursuant to the RTFC Bylaws, there are five districts for the membership, and each district is represented by two directors, each of whom must be a director, trustee, officer or manager of a member. Directors are elected at the annual meeting of the members. Each member is entitled to one vote and no more upon each matter submitted to a vote at all meetings of the members. There are no CFC directors, officers or employees that serve as a director for RTFC.

The RTFC Board of Directors established an Executive Committee of the Board of Directors pursuant to a written board policy that sets forth the delegations of responsibility, authorities and functions of the Executive Committee of the Board of Directors. The board policy delegates to the Executive Committee the authority to advise and consult with the Chief Executive Officer with respect to the development of policies governing RTFC's making of loans, guarantees and investments to or for the benefit of members.

The RTFC Board of Directors reserves the authority to approve certain loans and guarantees based on the loan amount, credit quality and other criteria established by the Board of Directors from time to time. During intervals between Board meetings, the Executive Committee may consider and approve financing arrangements that require approval by the full Board. The Board of Directors delegates to the Chief Executive Officer or to the Chief Executive Officer's designee(s) the authority to approve certain financing arrangements up to certain dollar thresholds and with certain credit characteristics and also authorizes the Chief Executive Officer to establish an internal Corporate Credit Committee.

One of the loan policies established by RTFC's Board of Directors sets forth the loan guidelines and credit products established to implement the corporate purpose and program objectives of RTFC. Loans and guarantees are made to members, affiliates of members and associates that meet applicable financial and feasibility criteria, security requirements and conditions as established for each type of loan pursuant to RTFC's practices and procedures in effect at the time. A credit analysis is conducted by staff during the underwriting process for each application to determine if the applicant has the ability to meet its obligations and RTFC's financial standards and if the proposed structure provides adequate security for each secured credit facility. RTFC's Board of Directors delegates to the Chief Executive Officer or the Chief Executive Officer's designee(s) the authority to implement this policy.

NCSC

The business affairs of the association are managed by a Board of 11 directors. Pursuant to the NCSC Bylaws, there are five districts for the general membership and one district for CFC. The five general membership districts are represented by two directors, one of which must be a director or trustee of a member and one of which must be a manager of a member. Directors are elected at the annual meeting of the members. Each member is entitled to one vote and no more upon each matter submitted to a vote at all meetings of the members. The membership of the sixth district, or CFC, nominates one director for election by the members that may be a CFC director, officer or manager.

The NCSC Board of Directors established an Executive Committee of the Board of Directors pursuant to a written board policy that sets forth the delegations of responsibility, authorities and functions of the Executive Committee of the Board of Directors. The board policy delegates to the Executive Committee the authority to advise and consult with the Chief Executive Officer with respect to the development of policies governing NCSC's making of loans, guarantees and investments to or for the benefit of members.

The NCSC Board of Directors has the authority to approve certain loans and guarantees based on the loan amount, credit quality and other criteria established by the Board of Directors from time to time. During intervals between Board meetings, the Executive Committee may consider and approve financing arrangements that require approval by the full Board. The Board of Directors delegates to the Chief Executive Officer or to the Chief Executive Officer's designee(s) the authority to approve certain financing arrangements up to certain dollar thresholds and with certain credit characteristics and also authorizes the Chief Executive Officer to establish an internal Corporate Credit Committee.

One of the loan policies established by NCSC's Board of Directors sets forth the loan guidelines and credit products established to implement the corporate purpose and program objectives of NCSC. Loans and guarantees are made to members, affiliates of members and associates that meet applicable financial and feasibility criteria, security requirements, and conditions as established for each type of loan pursuant to NCSC's practices and procedures in effect at the time. A credit analysis is conducted by staff during the underwriting process for each application to determine if the applicant has the ability to meet its obligations and NCSC's financial standards and if the proposed structure provides adequate security for each secured credit facility. NCSC's Board of Directors has delegated to the Chief Executive Officer or the Chief Executive Officer's designee(s) the authority to implement this policy.

Rural Electric Industry

Since the enactment of the Rural Electrification Act in 1936, RUS has financed the construction of electric generating plants, transmission facilities and distribution systems to provide electricity to rural areas. Principally through the creation of local electric cooperatives originally financed under the Rural Electrification Act loan program in 47 states and three U.S. territories, the percentage of farms and residences in rural areas of the United States receiving central station electric service increased from 11 percent in 1934 to almost 100 percent currently. According to May 2009 estimates from the National Rural Electric Cooperative Association, which we believe to be consistent with current estimates, rural electric systems serve approximately 12 percent of all consumers of electricity in the United States and its territories and serve about 7 consumers per mile of line, compared with 35 customers per mile of line for other utilities. Based on prior estimates, we believe that rural electric systems account for approximately 8 percent of total sales of electricity and own about 5 percent of the nation's electricity generating capacity.

RUS makes insured loans and loan guarantees and provides other forms of financial assistance to electric borrowers. RUS is authorized to make direct loans to systems that qualify for the hardship program (5 percent interest rate) or the municipal rate program (based on a municipal government obligation index). RUS is also authorized to guarantee loans that bear interest at a rate agreed upon by the borrower and the lender (which generally has been the Federal Financing Bank). 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 assets and revenues.

Leading up to CFC's formation in 1969, there was a growing need for capital for electric cooperatives to build new electric facilities due to growth in rural America. The electric cooperatives formed CFC so a source of financing would be available to them to supplement the RUS loan programs and to mitigate uncertainty related to government funding. Providing the electric cooperatives with financial products and services to supplement the RUS loan programs remains the purpose of CFC.

CFC aggregates the combined strength of the rural electric cooperatives to access the public capital markets and fill the need to provide supplemental funding to that of RUS. CFC is owned by its consumer-owned electric cooperative members. CFC works cooperatively with RUS; however CFC is not a Federal agency or a government-sponsored enterprise, and is not owned or controlled by any federal agency or government-sponsored enterprise. Our members are not required to have outstanding loans from RUS as a condition of borrowing from CFC. CFC supplements the RUS financing programs to meet the financial needs of its rural members in the following ways:

- providing bridge loans required by borrowers in anticipation of receiving RUS funding;
- providing financial products not otherwise available from RUS including lines of credit, letters of credit, guarantees on tax-exempt financing (usually for pollution-control equipment), weather-related disaster recovery lines of credit, unsecured loans, and investment products such as commercial paper and member capital securities;
- meeting the financing needs of those rural electric systems that repay or prepay their RUS loans and replace the government loans with private capital; and
- providing financing to RUS-eligible rural electric systems for facilities that are not eligible for financing from RUS. Examples of such facilities include electric utility facilities acquired by a cooperative from an investor-owned or municipal utility for service to an area that falls outside of an eligible rural area, as defined in the Rural Electrification Act. In other cases, an RUS-eligible system obtains CFC financing for non-electric facilities used by the cooperative to serve its rural members when such facilities are not eligible for RUS loans. More recently, RUS has instituted restrictions on financing for certain baseload generation facilities. A cooperative in the process of constructing such facilities will need financing to complete this work and because of the recent change in RUS policy, it may not be able to obtain this additional funding from RUS.

Electric Systems and Associations

Distribution Systems

Distribution systems are utilities engaged in retail sales of electricity to residential and commercial consumers in their defined service areas generally on an exclusive basis using their distribution infrastructure including substations, wires and related support systems. Distribution systems are cooperatives owned by the customers they serve. Distribution systems vary in size from small systems that serve a few thousand customers to large systems that serve more than 200,000 customers. Thus, the amount of loan funding required by different distribution systems varies significantly.

Distribution systems may service customers in more than one state.

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 contracts with government agencies, investor-owned utilities and other entities, and in some cases, the distribution systems own generating facilities.

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 consumer. The distribution systems are the members of the power supply systems. The power supply systems vary in size from one with hundreds of megawatts of power generation capacity to systems that have no generating capacity, which generally operate transmission lines to supply certain distribution systems or manage power supply purchase arrangements for the benefit of their distribution system members. Certain other power supply systems have been formed but do not yet own generating or transmission facilities or have financing commitments from us. Thus, the amount of loan funding required by different power supply systems varies significantly. Power supply members may serve distribution systems located in more than one state.

The wholesale power supply contracts with their distribution system members permit the power supply system, subject to regulatory approval in certain instances, to establish rates to produce revenues sufficient to meet the cost of operation and maintenance of all generating, transmission and related facilities and to pay the cost of any power and energy purchased for resale.

Statewide and Regional Associations
Each state may have an organization that represents and serves the distribution systems and power supply systems located in the state. Such statewide organizations provide training, as well as legislative, regulatory, media and related representation for the member distribution and power supply systems.

National Associations of Cooperatives
The National Rural Electric Cooperative Association represents cooperatives nationally. It provides training, sponsors regional and national meetings, and provides legislative, regulatory, media, and related representation for all rural electric cooperatives.

Electric Member Competition
The movement toward electric competition at the retail level has subsided, while the wholesale level has become somewhat competitive. The electric utility industry has settled into a "hybrid" model in which there are significant differences in the retail regulatory approaches followed in different states and regions.

Customer choice regulation, where customers have a choice of alternative energy suppliers, has had little to no impact on distribution and power supply cooperatives, and we do not expect a material impact going forward. As of May 31, 2010, retail customer choice is active in 15 states. Those states are Connecticut, Delaware, Illinois, Maine, Maryland, Massachusetts, Michigan, New Hampshire, New Jersey, New York, Ohio, Oregon, Pennsylvania, Rhode Island and Texas. In general, even in those states, very few customers switched from the traditional supplier.

Many factors influence the choices customers have available to them and, therefore, mitigate the effect of customer choice and competition in areas served by cooperatives. These factors include, but are not limited to, the following:

- utilities in many states may still be regulated regarding rates on non-competitive services, such as distribution;
- 20 states regulate the debt securities issued by utilities, including cooperatives, which could affect funding costs and, therefore, the electric rates charged to customers;
- Federal Energy Regulatory Commission regulation of rates as well as terms and conditions of transmission service;
- the fact that few competitors demonstrated much interest in providing electric energy to residential or rural customers; and
    - 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 still charge a fee or access tariff for the service of delivering power, regardless of who supplies the power.

Electric Member Regulation
There are 14 states that fully or partially regulate the rates electric cooperative systems charge. Those states are Arizona, Arkansas, Georgia, Hawaii, Kentucky, Louisiana, Maine, Maryland, New Mexico, New York, Utah, Vermont, Virginia and West Virginia. In these 14 states, we had 155 distribution members and 12 power supply members with a total of $3,970 million of loans outstanding at May 31, 2010. Two of these states (Georgia and Utah) have partial oversight authority over the cooperatives' rates, but not the specific authority to set rates. As of May 31, 2010, we had loans outstanding in the amount of $1,973 million in those states. There are 11 states that allow

cooperatives the right to opt in or out of state regulation. There are 20 states that regulate electric systems' issuance of debt (although one of these states, New Mexico, does not regulate any loans to RUS borrowers). FERC also has jurisdiction to regulate transmission rates, wholesale rates, terms and conditions of service, and the issuance of securities by public utilities within its jurisdiction, which includes only a few cooperatives.

Our distribution and power supply members are subject to regulation by various federal, regional, state and local authorities with respect to the environmental effects of their operations, including air and water quality control, solid and hazardous waste disposal, and limitations on land use. In addition, federal and state statutes authorize governmental agencies to compel responsible parties to clean up certain abandoned or unremediated hazardous waste sites. Our members may incur costs to clean up currently or formerly owned facilities or sites found to be contaminated, as well as other facilities or sites that may have been contaminated due to past disposal practices. While we cannot currently estimate projected expenditures related to these laws and regulations for our members, we believe the financial impact of these laws and regulations on our members will be passed through to their customers.

Global climate legislation remains a hotly debated issue on Capitol Hill. On June 26, 2009, the House of Representatives passed H.R. 2454, the "American Clean Energy and Security Act of 2009", also known as the Waxman-Markey climate change bill. This bill would cap U.S. carbon dioxide emissions, including those of electric utilities. Specifically, the bill requires that carbon dioxide emissions be reduced below 2005 levels by 17 percent by 2020, 42 percent by 2030, and 83 percent by 2050. The bill would provide allowances for a defined time period free of charge to certain entities, including to electric utilities. These allowances would permit entities to emit above the capped level and be allocated to certain entities to cover a portion of the required reductions.

On December 7, 2009, the Environmental Protection Agency issued an Endangerment Finding concluding that greenhouse gas emissions contribute to global warming and threaten the public health and welfare of current and future generations. This action effectively allows the Environmental Protection Agency to regulate carbon dioxide emissions under the Clean Air Act without further Congressional action.

The Senate continues to debate varying versions of climate change legislation, including legislation that would prevent the Environmental Protection Agency from regulating greenhouse gases under the Clean Air Act. At this time, it is unclear whether global climate change legislation will become law and, if enacted, what specific requirements will be imposed on electric utilities. We closely monitor the legislative activity on climate change, as well as the debate on the various proposals under consideration, and we will continue to monitor this activity. Because of the continuing uncertainty regarding the context and timing of potential climate change legislation, we are unable, at this time, to determine the effect of such potential requirements on us or our members.

Rural Telecommunications Industry

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 approximately 1,300 companies are called independent because they are not affiliated with Verizon or AT&T. Included in the 1,300 total are approximately 250 not-for-profit cooperative telecommunications companies. A majority of the remainder of these independent rural telecommunications companies are privately held commercial companies. Less than 20 of these commercial companies are publicly traded or have issued bonds in the capital markets.

Rural telecommunications companies, including all local exchange carriers other than Verizon, AT&T, Qwest, Cincinnati Bell and CenturyLink, comprise less than 15 percent of the local exchange telecommunications industry that provides service to more than 125 million access lines. These rural companies range in size from fewer than 100 customers to more than three million. Rural telecommunications companies' annual operating revenues range from less than $100,000 to more than $2,000 million. In addition to basic local exchange and access telecommunications service, most independents offer other communications services including wireless voice and data, cable television and high-speed Internet access. Most rural telecommunications companies' networks incorporate digital switching, fiber optics, Internet protocol (IP) telephony and other advanced technologies.

Telecommunications Competition

The Telecommunications Act of 1996 created a framework for competition and deregulation in the local telecommunications market. As a result, competition continues to be a significant factor in the telecommunications industry. A July 2009 Federal Communications Commission ("FCC") report on telecom trends states that as of June 2008, competitive local exchange carriers provided service to 30 million access lines–19.4 percent of the nation's 155 million end-user switched access lines. Wireless carriers are providing service to 255 million mobile telephone service subscriptions–more than local exchange carriers and competitive local exchange carriers combined. For the most part, local exchange competition has benefited rural local exchange carriers by enabling them to enter nearby towns and cities as competitive local exchange carriers, leveraging their existing infrastructure and reputation for providing high-quality, modern telecommunications service. Rural local exchange carriers enjoy an exemption from the Telecom Act requirement to provide competitors with access to their networks, absent a determination that it would be in the public interest to do so. Relatively few rural local exchange carriers have competitive local exchange carriers request access to their networks.

The national goal of universal service is accomplished through a support mechanism (the Universal Service Fund) that is required to be: (1) sufficient to ensure that rural customers receive reasonably comparable rates and services to urban customers and (2) portable; that is, available to all eligible providers. The Universal Service Fund provides support for rural local exchange carriers with costs significantly above the national average. In addition, implicit subsidies long contained in the access charges local telecommunications companies' levy on long-distance carriers have largely been eliminated. As these access charges have been reduced, rural local exchange carriers have been made whole by cost recovery being moved to the Universal Service Fund. The Universal Service Fund is an important revenue source for most rural local exchange carriers.

The nexus between competition and universal service is the issue of competitor eligibility for universal service funding–the "portability" feature of the Universal Service Fund. As noted above, few wireline competitors attempted to enter rural markets. Numerous wireless carriers have extended their coverage areas into rural markets. 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 based on the incumbent local exchange carriers costs (the "identical support" rule). This has led to growth in claims on the fund and great concern for its sustainability. The Universal Service Fund's current funding base of interstate telecommunications revenues is shrinking as long distance minutes-of-use decline due to wireless, e-mail and voice-over-Internet protocol substitution. Increased demand for funding from the Universal Service Fund has resulted in the rate assessed on all participants in the nationwide network (the "contribution factor") becoming unsustainably high. The third quarter 2010 contribution factor is 13.6 percent of interstate and international long distance revenue.

Telecommunications Regulation
Rural telecommunications systems generally are regulated at the state and federal levels. Most state commissions regulate local service rates, intrastate access rates and telecommunications company borrowing. The FCC regulates interstate access rates and the issuance of licenses required to operate certain types of telecom operations. Some rural telecommunications systems have affiliated companies that are not regulated.

While nearly all industry participants agree that changes need to be made regarding eligibility and the funding mechanism for the Universal Service Fund, there is no agreement on what those changes should be. In May 2008, the FCC ordered that payments to competitive eligible telecommunications carriers be capped. Total support for a competitive eligible telecommunications carrier is capped at what it was eligible to receive in March 2009. In January 2008, the FCC opened proceedings on universal service funding. These related proceedings addressed creation of separate funds for incumbents and competitive eligible telecommunications carriers, elimination of the "identical support" rule and a transition to a "reverse auction" regime for determining the amount of Universal Service Fund support an eligible carrier would receive. No consensus solution has been reached by the FCC. It is unclear what action, if any, the FCC ultimately will take with respect to this matter.

The FCC also has a proceeding open on intercarrier compensation–the most important components of which are access fees local exchange carriers charge to interexchange carriers that originate or terminate long-distance traffic on local exchange carriers' networks. While the large local exchange carriers (most of which now own long-distance companies) would like to see these fees transition to zero, rural local exchange carriers depend heavily on access charges and have been active participants in the FCC proceeding. No action has yet been taken in this proceeding and, like the Universal Service Fund, it remains to be dealt with by the FCC under Chairman Julius Genachowski. At present, most regulatory activity centers on the FCC's National Broadband Plan, which deals with all of these difficult issues in a holistic approach. It is unclear what will be the outcome of this process.

While uncertainty exists regarding the Universal Service Fund and access, we do not anticipate that any changes to the Universal Service Fund will result in our member rural local exchange carriers suffering revenue losses significant enough to cause material losses on our outstanding loans.

Deregulation has not had a significant effect on the wireline local exchange carrier business segment thus far. The FCC continues to regulate wireline telephony under Title II of the Act. Internet, video, wireless and competitive local exchange services are much less regulated. However, in pursuit of its net neutrality policy, the FCC is now investigating ways to regulate broadband communications after having previously considered Internet services to be information service exempt from Title II regulation. Most rural local exchange carriers are expanding their service offerings to customers in less regulated business segments. With few competitors in the most rural parts of their service areas, rural local exchange carriers generally have been successful in these growth and diversification efforts.

Disaster Recovery

We have continued to use a comprehensive disaster recovery and business continuity plan since May of 2001. The plan includes a duplication of our production information systems at an offsite facility coupled with an extensive business recovery plan to use those remote systems. Our production data is replicated in real time to the recovery site 24 hours a day, seven days a week.

The plan also includes steps for each of our operating groups to conduct business with a view to minimizing disruption for our members and other parties with whom we do business. We conduct disaster recovery exercises twice a year that include both the information technology group and business areas. We contract with an external vendor for the facilities to house the backup systems that we own as well as office space and related office equipment. In January 2009, we moved our disaster recovery offsite facility from New Jersey to a location in western Virginia to allow for quicker access by employees to the site in the event of a disaster. We also implemented data duplication technology to provide backup to disks where backup data are also replicated to our disaster recovery site. In 2010, we started a virtual recovery program to improve our remote access capabilities to address potential business disruptions such as weather-related events or pandemics.

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.

In order for CFC to maintain its exemption under Section 501(c)(4) of the Internal Revenue Code, CFC must be "not organized for profit" and must be "operated exclusively for the promotion of social welfare" within the meaning of that section of the tax code. The Internal Revenue Service determined that CFC is an organization that is "operated exclusively for the promotion of social welfare" because the ultimate beneficiaries of its lending activities, like those of the RUS loan program, are the consumers of electricity produced by rural electric systems, the communities served by these systems and the nation as a whole.

As an organization described under Section 501(c)(4) of the Internal Revenue Code, no part of CFC's net earnings can inure to the benefit of any private shareholder or individual. This requirement is referred to as the private inurement prohibition and was added to Section 501(c)(4) of the Internal Revenue Code in 1996. A legislative exception allows organizations like CFC to continue to make allocations of net earnings to members in accordance with its cooperative status.

CFC believes its operations have not changed materially from those described to the Internal Revenue Service in its exemption filing. CFC reviews the impact on operations of any new activity or potential change in product offerings or business in general to determine whether such change in activity or operations would be inconsistent with its status as an organization described under Section 501(c)(4).

RTFC is a taxable cooperative under Subchapter T of the Internal Revenue Code and is not subject to income taxes on income from patronage sources which is allocated to its borrowers, as long as the allocation is properly noticed and at least 20 percent of the amount allocated is retired in cash prior to filing the applicable tax return. RTFC pays income tax based on its net income, excluding amounts allocated to its borrowers.

NCSC is a taxable cooperative which is subject to income tax annually based on its net income for the period. We believe that NCSC would qualify under Subchapter T of the Internal Revenue Code, and thus it would not be subject to income taxes on patronage sourced net earnings allocated to its borrowers, as long as the allocation is properly noticed and at least 20 percent of the amount allocated is retired in cash prior to filing the applicable tax return. To date, NCSC's Board of Directors has not allocated its patronage sourced net earnings to members, thus NCSC pays income tax on the full amount of its net income.

Allocation and Retirement of Patronage Capital

District of Columbia cooperative law requires cooperatives to allocate net earnings to patrons, to a general reserve in an amount to maintain a balance of at least 50 percent of paid-up capital, and to a cooperative educational fund, as well as permits additional allocations to board-approved reserves. District of Columbia cooperative law also requires that a coooperative's net earnings be allocated to all patrons in proportion to their individual patronage and each patron's allocation be distributed to the patron unless the patron agrees that the cooperative may retain its share as additional capital.

CFC

Annually, CFC’s Board of Directors allocates its net earnings to its patrons in the form of patronage capital, to a cooperative educational fund, to a general fund, if necessary, and to board-approved reserves. Net earnings are calculated by adjusting net income to exclude the non-cash effects of the accounting for derivative financial instruments and foreign currency translation. Negative net earnings, if any, are not allocated to members or to the reserves and do not affect amounts previously allocated as patronage capital or to the reserves. Net earnings may first be used to offset prior period losses, if any.

An allocation to the general fund is made, if necessary, to maintain the balance of the general fund at 50 percent of the membership fees collected. CFC’s bylaws require the allocation to the cooperative educational fund to be at least 0.25 percent of its net earnings. Funds from the cooperative educational fund are disbursed annually to statewide cooperative organizations to fund the teaching of cooperative principles and for other cooperative education programs.

Currently, CFC has one additional board-approved reserve, the members’ capital reserve. CFC’s Board of Directors determines the amount of net earnings that is allocated to the members’ capital reserve, if any. The members’ capital reserve represents net earnings that CFC holds to increase equity retention. The net earnings held in the members’ capital reserve have not been specifically allocated to members, but may be allocated to individual members in the future as patronage capital if authorized by CFC’s Board of Directors.

All remaining net earnings are allocated to CFC’s members in the form of patronage capital. The amount of net earnings allocated to each member is based on the members’ patronage of CFC’s lending programs during the year. No interest is earned by members on allocated patronage capital. There is no effect on CFC’s total equity as a result of allocating net earnings to members in the form of patronage capital or to board-approved reserves. CFC’s Board of Directors has voted annually to retire a portion of the patronage capital allocation. Upon retirement, patronage capital is paid out in cash to the members to whom it was allocated. CFC’s total equity is reduced by the amount of patronage capital retired to its members and by amounts disbursed from board-approved reserves.

Pursuant to CFC’s bylaws, CFC’s Board of Directors shall determine the method, basis, priority and order of retirement of amounts allocated. The current policy of the CFC Board of Directors is to retire 50 percent of the prior fiscal year’s allocated net earnings following the end of each fiscal year and to hold the remaining 50 percent for 25 years to fund operations. The amount and timing of future retirements remains subject to annual approval by CFC’s Board of Directors, and may be affected by CFC’s financial condition and other factors. CFC’s Board of Directors has the authority to change the current practice for allocating and retiring net earnings at any time, subject to applicable cooperative law.

RTFC

In accordance with District of Columbia cooperative law and its bylaws and board policies, RTFC allocates its net earnings to its patrons, a cooperative educational fund and a general reserve, if necessary. Negative net earnings, if any, are not allocated to members or to the reserves and do not affect amounts previously allocated as patronage capital or to the reserves. Net earnings may first be used to offset prior period losses, if any.

Pursuant to RTFC’s bylaws, RTFC’s Board of Directors shall determine the method, basis, priority and order of retirement of amounts allocated. RTFC’s bylaws require that it allocate at least 1 percent of net earnings to a cooperative educational fund. Funds from the cooperative educational fund are disbursed annually to fund the teaching of cooperative principles and for other cooperative education programs. An allocation to the general fund is made, if necessary, to maintain the balance of the general fund at 50 percent of the membership fees collected. The remainder is allocated to borrowers in proportion to their patronage. RTFC provides notice to its members of the amount allocated and retires 20 percent of the allocation for that year in cash prior to the filing of the applicable tax return. Any additional amounts are retired as determined by RTFC’s Board of Directors with due regard for RTFC’s financial condition. There is no effect on the balance of non-controlling interest due to the allocation of net earnings to members or board-approved reserves. The retirement of amounts previously allocated to members or amounts disbursed from Board approved reserves reduces the balance of non-controlling interest.

NCSC

In accordance with District of Columbia cooperative law and its bylaws and board policies, NCSC allocates its net earnings to a cooperative educational fund, to a general fund, if necessary, and to board-approved reserves. Net earnings are calculated by adjusting net income to exclude the non-cash effects of the accounting for derivative financial instruments and foreign currency translation. Negative net earnings, if any, are not allocated to members or to the reserves and do not affect amounts previously allocated as patronage capital or to the reserves. Net earnings may first be used to offset prior period losses, if any.

Pursuant to NCSC’s bylaws, the NCSC’s Board of Directors shall determine the method, basis, priority and order of retirement of amounts allocated. An allocation to the general fund is made, if necessary, to maintain the balance of the general fund at 50 percent of the membership fees collected. NCSC’s bylaws require the allocation to the cooperative educational fund to be at least 0.25 percent of its net earnings. Funds from the cooperative educational fund are disbursed annually to fund the teaching of cooperative principles and for other cooperative education programs. To date, NCSC has not allocated net earnings to members. NCSC's Board of Directors has retained prior net earnings as operating capital. The NCSC Board of Directors has the authority to determine when and if patronage sourced net earnings will be allocated and retired. There is no effect on the balance of non-controlling interest due to the allocation of net earnings to board-approved reserves. The amounts disbursed from board-approved reserves reduce the balance of non-controlling interest.

Investment Policy

Surplus funds are invested based on policies adopted by our 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 securities. 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. In addition, this policy permits investments in the Federal Agricultural Mortgage Corporation.

Employees

At May 31, 2010, we had 227 employees, including financial and legal personnel, management specialists, credit analysts, accountants and support staff. We believe that our relations with our employees are good.

Item 1A. Risk Factors

Our financial condition, results of operations and liquidity are subject to various risks and uncertainties inherent in our business. The risks described below are only the risks we consider to be the most material to our business. Be aware that other risks may prove to be material or important in the future. If any of the events or circumstances described in the following risks actually occur, our business, financial condition or results of operations could suffer adversely. You should consider all of the following risks together with all of the other information in this Annual Report on Form 10-K.

Our ability to maintain and grow our business depends on access to external financing.
We depend on access to the capital markets to fund new loan advances and refinance our long-term and short-term debt and, if necessary, to fulfill our obligations under our guarantee and repurchase agreements. We cannot assure that we will be able to raise capital in the future at all or on terms that are acceptable to us. Market disruptions, downgrades to our long-term debt ratings and/or short-term debt ratings, downturns in the rural electric or rural telephone industries and other events over which we have no control may deny or limit our access to the capital markets and/or subject us to higher costs for such funding.

At May 31, 2010, we had $2,294 million of commercial paper, daily liquidity fund and bank bid notes and $2,312 million of medium-term notes, collateral trust bonds and long-term notes payable scheduled to mature during the next 12 months. At May 31, 2010, we were the guarantor and liquidity provider for $549 million of tax-exempt bonds issued for our member cooperatives. If we lose the ability to issue debt into the capital markets, we may not have the funds to meet all of these obligations as they become due. Increases in the interest rates we pay on the short- and long-term debt we issue in the capital markets would negatively affect our operations, including our ability make new loans.

Fluctuating interest rates could adversely affect our income, margin and cash flow.
We are a cost-based lender that sets our interest rates on loans based on our cost of funding. We set our line of credit interest rate and long-term variable interest rate monthly based on the cost of our underlying funding. We do not match fund the majority of our long-term fixed-rate loans with a specific debt issuance at the time the loans are advanced. Instead, long-term fixed-rate loans are aggregated until the volume reaches a level that will allow an economically efficient issuance of long-term debt to fund long-term fixed-rate loans. As such, we are exposed to interest rate risk on our long-term fixed-rate loans during the period from which we have set a fixed rate on the loan until the time we obtain the long-term funding for the loan from the market. At May 31, 2010, fixed-rate loans funded with variable-rate debt totaled $648 million, or 3 percent of total assets and total assets excluding derivative assets.

A decrease in long-term fixed interest rates provided by other lenders could result in an increase in loan prepayments on loans with a fixed-rate term expiring. Borrowers are able to prepay the long-term fixed-rate loan without a make-whole fee at the time the fixed-rate term expires and the loan reprices. An increase in loan prepayments due to repricings could cause a decrease to earnings for the period of time it takes to use cash from such prepayments to repay maturing debt or make new loan advances. At May 31, 2010, a total of $1,775 million of fixed-rate loans have a fixed-rate term scheduled to reprice during the next 12 months.

In addition, the calculated impairment on certain restructured loans will increase as our long-term variable and short-term interest rates increase. Based on the current balance of impaired loans at May 31, 2010, an increase or decrease of 25 basis points to our variable interest rates results in an increase or decrease of approximately $9 million, respectively, to the calculated impairment on loans irrespective of a change in the credit fundamentals of the impaired borrower.

Increases in the level of government funding available to rural electric and rural telecommunications systems could reduce our members' demand for financing from us.
The majority of our members are eligible to borrow from RUS. 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 our ability to maintain loan volume.

Competition from other lenders could impair our financial results.
We compete with other lenders for the portion of the rural utility loan demand for which RUS will not lend and for loans to members who have elected not to borrow from RUS. The primary competition for the non-RUS loan volume is from CoBank, ACB, a federally chartered instrumentality of the United States that is a member of the Farm Credit System. As a government-

sponsored enterprise, CoBank, ACB, has the benefit of an implied government guarantee. Competition may limit our ability to raise rates to cover all increases in costs and may cause a reduction in new lending business and negatively impact net income.

We are subject to credit risks related to collecting the amounts owed to us on our outstanding loans. Increased credit risk related to our loans or actual losses that exceed our allowance for loan losses could impair our financial results. Our 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 loan portfolio. The level of the allowance reflects management’s continuing evaluation of credit risk related to industry concentrations; economic conditions; 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 us 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 our 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, we will need additional provisions to increase the allowance for loan losses. Any material increases in the allowance for loan losses will result in a decrease in net income, and may have a material adverse effect on our financial results.

We have 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 us or initiate actions against us related to the loan documents. Unfavorable rulings in these cases that result in loan losses that exceed the related allowance could have a material adverse effect on our financial results.

The performance of assets we obtain through foreclosure could impair our financial results.
Periodically, we foreclose on assets that are pledged as collateral on loans as a result of the failure of the borrower to make the agreed-upon payments. When we foreclose on these assets, we are attempting to maximize our recovery on the loan through the ongoing operations and future sale of the underlying assets.

As the owner of foreclosed assets, we are subject to the same performance and financial risks as any owner of similar assets. In particular, we are at risk that the value of the foreclosed assets deteriorates, negatively affecting our results of operations. Each quarter, the foreclosed assets are evaluated for impairment. Impairment charges, if required, represent a reduction to current period earnings. There may be substantial judgment used in the determination of whether such assets are impaired and in the calculation of the amount of the impairment. In addition, when foreclosed assets are sold to a third party, the sale price we receive may be below the amount previously recorded in our financial statements, which will result in a loss being recorded in the period of the sale.

The non-performance of counterparties to our derivative agreements could impair our financial results.
We use interest rate swaps to manage our interest rate risk. There is a risk that the counterparties to these agreements will not perform as agreed, which could adversely affect our results of operations. The non-performance of a counterparty on an agreement would result in the derivative no longer being an effective risk management tool, which could negatively affect our overall interest rate risk position. In addition, if a counterparty fails to perform on our derivative obligation, we could incur a financial loss to replace the derivative with another counterparty and/or a loss through the failure of the counterparty to pay us amounts owed.

At May 31, 2010, we were a party to derivative instruments with notional amounts totaling $11,114 million. At May 31, 2010, the highest concentration of total notional exposure to any one counterparty was 12 percent of total derivative instruments. Based on the fair market value of our derivative instruments at May 31, 2010, there were seven counterparties that would be required to make payments to us totaling $43 million if all of our derivative instruments were terminated on that day. The largest amount owed to us by a single counterparty was $11 million, or 26 percent, of the total payments owed to us at May 31, 2010.

We also use our derivatives to synthetically create the substantive economic equivalent of various debt funding structures. Thus, if our access to the derivative markets were disrupted, it may be more difficult or expensive to fund our business activities and achieve a funding mix we desire, or could result in the derivative no longer being an effective risk management tool, which could negatively affect our overall interest rate risk position and could adversely affect our business and financial results.

A reduction in the credit ratings for our debt could adversely affect our liquidity.
Nationally recognized statistical rating organizations play an important role in determining, by means of the ratings they assign to issuers and their debt, the availability and cost of debt funding. We currently contract with two nationally recognized

statistical rating organizations to receive ratings for our secured and unsecured debt and our commercial paper. Our credit ratings are important to our liquidity. In order to access the commercial paper markets at current levels, we believe that we need to maintain our current ratings for commercial paper of P1 from Moody's Investors Service and A1 from Standard and Poor's Corporation. Actions by governmental entities or others, additional losses from impaired loans and other factors could adversely affect the credit ratings on our debt. A reduction in our credit ratings could adversely affect our liquidity, competitive position, or the supply or cost of debt financing available to us. A significant increase in our interest expense could cause us to sustain losses or impair our liquidity by requiring us to seek other sources of financing, which may be difficult to obtain.

A decline in our credit rating could trigger payments under our derivative agreements, which could impair our financial results.
We have certain interest rate swaps that contain credit risk-related contingent features referred to as rating triggers. Under certain rating triggers, if the credit rating for either counterparty falls to the level specified in the agreement, the other counterparty may, but is not obligated to, terminate the agreement. If either counterparty terminates the agreement, a net payment may be due from one counterparty to the other based on the fair value, excluding credit risk, of the underlying derivative instrument. These rating triggers are based on our senior unsecured credit rating from Moody's Investors Service and Standard & Poor's Corporation. Based on the fair market value of our interest rate exchange agreements subject to rating triggers at May 31, 2010, we may be required to make a payment of up to $98 million if our senior unsecured ratings from Moody's Investors Service falls to or below Baa1 or from Standard & Poor's Corporation falls to or below BBB+ and all agreements for which we owe amounts are terminated. In calculating the required payments, we only considered agreements that, when netted for each counterparty as allowed by the underlying master agreement, would require a payment upon termination. In the event that we are required to make a payment as a result of a rating trigger, it could have a material adverse impact on our financial results.

At May 31, 2010, our senior unsecured debt credit ratings from Moody's Investors Service and Standard & Poor's Corporation were A2 and A, respectively. While the rating triggers on our interest rate exchange agreements are not tied to the rating outlooks from Moody's Investors Service and Standard & Poor's Corporation, such rating outlooks may provide an indication of possible future movement in the ratings. At May 31, 2010, Moody's Investors Service had our ratings on stable outlook and Standard & Poor's Corporation had our ratings on a negative outlook.

Our concentration of loans to borrowers within rural electric and telephone industries could impair our revenues if either or both of those industries experience economic difficulties.
At May 31, 2010, 90 percent of our total exposure was to rural electric cooperatives and 8 percent was to rural telecommunications organizations. Factors that have a negative impact on our member rural electric cooperatives or rural telecommunications organizations results of operations would also impair their ability to make payments on our loans. If our members' results of operations materially deteriorate, we could be required to increase our loan loss allowance through provisions for loan loss on our income statement that would reduce reported net income.

Advances in technology may change the way electricity is generated and transmitted or the way telecommunications services are provided to businesses and consumers prior to the maturity of our loans to rural electric and telecommunications systems.
To the extent that advances in technology make our electric system members' power supply, transmission and/or distribution facilities, or our telecommunications system members' networks or services obsolete prior to the maturity of our loans, there could be an adverse impact on the ability of our members to repay such loans. This could lead to an increase in non-performing or restructured loans and an adverse impact on our results of operations.

Loss of our tax-exempt status could increase our tax liability.
CFC has been recognized by the Internal Revenue Service as an organization for which income is exempt from federal income taxation under Section 501(c)(4) of the Internal Revenue Code (other than any net income from an unrelated

trade or business). In order to maintain CFCs' tax-exempt status, it must continue to operate exclusively for the promotion of social welfare by operating on a cooperative basis for the benefit of its members by providing them cost-based financial products and services consistent with sound financial management, and no part of CFC's net earnings may inure to the benefit of any private shareholder or individual other than the allocation or return of net earnings or capital to its members in accordance with CFC's current bylaws and incorporating statute.

If CFC were to lose its status as a 501(c)(4) organization, we believe that it would be subject to the tax rules generally applicable to cooperatives under Subchapter T of the Internal Revenue Code. As a Subchapter T cooperative, CFC would be allowed to allocate its patronage-sourced income to its members and take a deduction for the amount of such patronage dividends that are paid in cash or qualified written notices of allocation. However, CFC would be taxed as a regular corporation on any income in excess of allowed deductions, if any.

We have liquidity risk related to our funding of long-term loans with short-term debt. Market disruptions or other factors that deny access or limit access to short-term debt markets could impair our operating results.
We use commercial paper and daily liquidity fund investments from our members and commercial paper sold in the capital markets as a portion of the funding for our long-term variable-rate loans and for our long-term fixed-rate loans during the period between the advance of the long-term fixed-rate loan and the time we have aggregated a sufficient need for long-term fixed-rate funding to more efficiently enter the capital markets. Market disruptions or other events that deny or limit our access to the short-term debt markets could impair our ability to roll over the commercial paper investments, which could adversely affect our financial results.

Our ability to comply with covenants related to our revolving credit agreements, debt indentures and debt agreements could affect our ability to retire patronage capital, may accelerate certain debt obligations and could affect our ability to obtain financing and maintain preferred rating levels on our debt.
We must maintain compliance with all covenants and conditions related to our revolving credit agreements and senior debt indentures.

We are required to maintain a minimum adjusted TIER for the six most recent fiscal quarters of 1.025, an adjusted leverage ratio of no more than 10 to 1 and we must maintain loans pledged as collateral for various debt issuances at or below 150 percent of the related secured debt outstanding as a condition to borrowing under our revolving credit agreements. Our revolving credit agreements also state that we must earn a minimum annual adjusted TIER of 1.05 in order to retire patronage capital to members. See Non-GAAP Financial Measures for further explanation and a reconciliation of our adjusted ratios.

If we are unable to borrow under the revolving credit agreements, our short-term debt ratings would most likely decline, and our ability to issue commercial paper could become significantly impaired. As a member-owned cooperative, all of our retained equity belongs to our members. As such, a restriction on the retirement of patronage capital in any year would result in a delay in the return of such amounts to the members until we earn an annual TIER of at least 1.05 and our board approves the retirement of the amounts allocated from the year in which retirement was restricted. A patronage capital retirement in any one year reduces the interest expense paid on a member's loan from CFC. Thus, if CFC does not retire patronage capital to its members, it results in a higher effective rate of borrowing from CFC for that year.

Pursuant to our collateral trust bond indentures, we are required (i) to maintain eligible collateral pledged at least equal to 100 percent of the principal amount of the bonds issued under the indenture, and (ii) to limit senior indebtedness to 20 times the sum of our members' equity and members' subordinated certificates. Our medium-term note indentures also require us to comply with (ii) above.

If we are in default under our collateral trust bond or medium-term note indentures, the existing holders of our collateral trust bonds or medium-term notes have the right to accelerate the repayment of the full amount of the outstanding debt principal before the stated maturity of such debt. That acceleration of debt repayments poses a significant liquidity risk as we might not have enough cash available to repay the debt. In addition, if we are not in compliance with the collateral trust bond and medium-term note covenants, we would be unable to issue new debt securities under such indentures. If we were unable to issue new collateral trust bonds and medium-term notes, our ability to fund new loan advances and refinance maturing debt would be impaired.

We are required to pledge eligible distribution system or power supply system loans as collateral equal to at least 100 percent of the outstanding balance of debt issued under the revolving debt issuance agreements with the Federal Agricultural Mortgage Corporation. We are also required to maintain distribution and power supply loans as collateral on deposit equal to at least 100 percent of the outstanding balance of debt under the Guaranteed Underwriter program of the U.S. Department of Agriculture which supports the Rural Economic Development Loan and Grant program.

Collateral coverage under 100 percent for either respective debt program constitutes an event of default, which if not cured within 30 days, could result in creditors accelerating the repayment of the outstanding debt principal before the stated maturity. This poses a liquidity risk of possibly not having enough cash available to repay the debt. In addition, we would be unable to issue new debt securities under the applicable debt agreement, which could impair our ability to fund new loan advances and refinance maturing debt.

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. In both September 2007 and 2008, we exercised the option to extend the lease for additional one-year periods. In March 2009, we amended the office space lease to extend the term until October 17, 2011, with the option to extend the lease for up to two additional one-year periods in fiscal year 2012 and 2013. The terms of these extensions are similar to the initial three-year lease.

CFC finalized a contract in May 2008 to purchase 42 acres of land located in Loudoun County, Virginia. In June 2010, CFC entered into a definitive agreement for a new headquarters facility using 16 of the 42 acres of land available. The excess land is available for room to grow if we need to expand in the future. Our new headquarters facility is scheduled for completion in the latter half of calendar year 2011. Our new headquarters facility will be approximately 120,000 square feet and will be constructed at a cost not expected to exceed $39.5 million. We do not expect the change from leasing to owning our headquarters building to have a material impact on our operating results because the annual cost of operating, maintaining and depreciating the new building is expected to be less than the annual cost of the current lease.

Item 3. Legal Proceedings.

None.

Item 4. [Removed and Reserved].

None.

PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Inapplicable.

Item 6. Selected Financial Data.

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

(dollar amounts in thousands)					
For the year ended May 31:	2010	2009 (11)	2008 (11)	2007 (11)	2006 (11)
Interest income	$ 1,043,635}	$ 1,070,764	$ 1,051,393	$ 1,039,650	$ 995,882
Net interest income	131,524}	135,743	120,125	47,896	18,682
Derivative (losses) gains (1)	(20,608)	(47,028)	(71,710)	7,161	109,688
Foreign currency adjustments (2)	-	-	-	(14,554)	(22,594)
Income (loss) prior to income taxes (3)	110,251}	(78,871)	36,311	16,541	105,762
Net income (loss) (3)	110,547}	(73,770)	39,646	14,145	102,586
Fixed charge coverage ratio (TIER) (4)(5)	1.12}	-	1.04	1.01	1.10
Adjusted TIER (6)	1.12}	1.10	1.15	1.12	1.11
As of May 31:					
Loans to members	$ 19,342,704}	$20,192,309	$19,029,040	$18,131,873	$18,363,954
Allowance for loan losses	(592,764)	(622,960)	(514,906)	(561,663)	(611,443)
Assets	20,143,215}	20,982,705	19,379,381	18,575,181	19,179,621
Short-term debt (7)	4,606,361}	4,867,864	6,327,453	4,427,123	5,343,824
Long-term debt (8)	12,054,497}	12,720,055	10,173,587	11,295,219	10,642,028
Subordinated deferrable debt (9)	311,440}	311,440	311,440	311,440	486,440
Members’ subordinated certificates	1,810,715}	1,740,054	1,406,779	1,381,447	1,427,960
Members’ equity (10)	669,355}	604,316	613,082	566,286	545,351
Total equity	586,767}	519,100	680,212	732,030	806,302
Guarantees	1,171,109}	1,275,455	1,037,140	1,074,374	1,078,980
Leverage ratio (5)	35.33}	41.88	29.01	25.84	24.13
Adjusted leverage ratio (6)	6.34}	7.06	7.48	6.82	6.40
Debt to equity ratio (5)	33.33}	39.42	27.49	24.37	22.79
Adjusted debt to equity ratio (6)	5.93}	6.59	7.04	6.39	5.98

(1) Amount represents changes in the fair value of derivative instruments (forward value) along with realized gains and losses from cash settlements. Derivative cash settlements represent the net settlements received/paid on interest rate and cross currency exchange agreements that do not qualify for hedge accounting. 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 transition adjustment recorded as an other comprehensive loss on June 1, 2001.

(2) Foreign currency adjustments represent the change in value of foreign denominated debt that is not related to an exchange agreement that qualifies for hedge accounting during the period and recorded in the statement of operations. The foreign denominated debt is revalued at each reporting date based on the current exchange rate. If 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. The adjustment to the debt is recorded in the foreign currency valuation account on the balance sheet. We enter 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 a one-time gain of $23 million from the proceeds of a settlement with CoBank, ACB, for the year ended May 31, 2010, and a $43 million gain on the sale of building and land for the year ended May 31, 2006.

(4) For the years ended May 31, 2010 and 2009, the fixed charge coverage ratio includes capitalized interest in total fixed charges, which is not included in our times interest earned ratio (“TIER”) calculation. For the years ended prior to May 31, 2009, the fixed charge coverage ratio is the same calculation as our TIER as we did not have any capitalized interest during those periods. For the year ended May 31, 2009, earnings were insufficient to cover fixed charges by $74 million.

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

(6) Adjusted ratios include non-GAAP adjustments that we make to financial measures in assessing our 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.

(7) Includes the foreign currency valuation account of $245 million at May 31, 2006. See further discussions in footnote (2) above.

(8) Excludes $2,312 million, $2,580 million, $3,177 million, $1,368 million and $1,839 million in long-term debt that comes due, matures and/or will be redeemed during fiscal years 2011, 2010, 2009, 2008 and 2007, respectively (see Note 5 to the consolidated financial statements).

(9) 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.

(10) Members’ equity represents total equity excluding foreign currency adjustments, derivative forward value, accumulated other comprehensive income and noncontrolling interest. See the Financial Condition/Liabilities and Equity section in Management’s Discussion and Analysis for further details of members’ equity and a reconciliation to total equity.

(11) Prior years have been revised to reflect the adjustments related to the implementation of new accounting standards for noncontrolling interests as described in Note 1(q) to the consolidated financial statements, as well as reclassifications to conform to the current reporting format as described in Note 1(aa) to the consolidated financial statements.

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

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

Throughout this management discussion and analysis, we will refer to our financial measures that are not in accordance with accounting principles generally accepted in the United States ("GAAP") as "adjusted." In our Executive Summary, our discussion will focus on the key metrics that we use to evaluate our business, which are adjusted TIER and adjusted debt to equity ratio. The most closely related GAAP measures are TIER and debt to equity ratio. For the year ended May 31, 2010, we reported a 1.12 TIER compared with a TIER below 1.00 for the year ended May 31, 2009, due to a net loss during that period. At May 31, 2010, our debt to equity ratio was 33.33 to 1 compared with a ratio of 39.42 to 1 at May 31, 2009. We do not measure our performance or evaluate our business based on the GAAP measures, and the financial covenants in our revolving credit agreements and debt indentures are based on our adjusted measures rather than the related GAAP measures. The main adjustments we make to calculate the non-GAAP measures compared to the related GAAP measures are to adjust interest expense to include derivative cash settlements; to adjust net income, senior debt and total equity to exclude the non-cash adjustments from the accounting for derivative financial instruments; to exclude from senior debt the amount that funds RUS guaranteed loans, subordinated deferrable debt and members' subordinated certificates; and to adjust total equity to include subordinated deferrable debt and members' subordinated certificates. See Non-GAAP Financial Measures for further explanation of the adjustments we make to our financial results for our own analysis and covenant compliance and for a reconciliation to the related GAAP measures.

Executive Summary

Our primary objective as a cooperative is to provide attractively priced financial products to our rural electric and telecommunications members while maintaining sound financial results required for investment-grade credit ratings on our debt instruments. As a member-owned cooperative lender, our objective is to offer our members cost-based financial products and services consistent with sound financial management and is not to maximize net income. Therefore, the rates we charge our borrowers reflect our adjusted interest expense plus a spread to cover our operating expenses, a provision for loan losses and earnings sufficient to preserve interest coverage to meet our financial objectives. Our key operating metrics are adjusted TIER and the adjusted debt to equity ratio. Our goal is to earn an annual minimum adjusted TIER of 1.10.

Results of Operations

For the year ended May 31, 2010, we earned an adjusted TIER of 1.12 compared with an adjusted TIER of 1.10 for the year ended May 31, 2009. Our adjusted net income for the year ended May 31, 2010 included the recognition of a one-time gain of $23 million from the proceeds of a settlement with CoBank, ACB, related to its accessing of confidential and proprietary information from our password-protected website for members without proper authority. The adjusted TIER for the period excluding the settlement proceeds was 1.09. The primary items that affected our adjusted TIER during the year ended May 31, 2010 are described below.

Liquidity Management

Liquidity has been a primary concern of investors and the rating agencies since the financial crisis began in the fall of 2008. To help mitigate liquidity risks during the year ended May 31, 2010, we issued more term debt and relied less on lower-cost commercial paper. By issuing more long-term debt and maintaining our commercial paper issuance capacity in reserve, we reduced the risk associated with refinancing short-term debt maturities. During the year ended May 31, 2010, our average balance of commercial paper outstanding decreased by approximately 34 percent compared to the prior-year period. This change in the overall mix of funding to use more term debt was successful in mitigating liquidity risks, but prevented us from realizing the potential reduction to interest expense available through fully utilizing our commercial paper issuance authority in the current low interest rate environment. We expect to increase the use of commercial paper in our funding mix in fiscal year 2011 compared to the utilization during fiscal year 2010 to achieve our goal of a minimum adjusted TIER of 1.10.

High Corporate Debt Spreads

In October 2008, we issued a $1,000 million collateral trust bond maturing in 2018 with a coupon of 10.375 percent. There were a number of factors that influenced our decision to issue this debt at a time when the markets were experiencing a significant disruption. We had maturing debt requiring refinancing, we delayed a planned private placement of debt due to financial difficulties our financial partner was experiencing and there was increased demand for loan funds from our members. The issuance of this bond resulted in higher interest expense of $57 million more than if we issued the bond at an average cost of debt consistent with the cost of debt prior to the financial crisis, or 4.68 percent for the quarter ended August 31, 2008. During the year ended May 31, 2010, the spread over comparable treasuries on corporate bonds decreased significantly. In September 2009, we issued $250 million of 2.625 percent collateral trust bonds with a three-year maturity at a spread of 125 basis points and $250 million of 3.875 percent collateral trust bonds with a six-year maturity at a spread of 158 basis points. Corporate debt spreads have continued to tighten since that time.

Non-Accrual Loans

At May 31, 2010, we had $561 million of non-performing loans on non-accrual status, which resulted in approximately $29 million of foregone interest for the year ended May 31, 2010, the majority of which related to our non-performing loan to Innovative Communication Corporation (“ICC”). At May 31, 2010, we also had a $462 million restructured loan to Denton County Electric Cooperative, d/b/a CoServ Electric (“CoServ”) on non-accrual status. We are not recognizing interest income on this loan; however, as long as it remains on non-accrual status, we experience a reduction in the calculated impairment and, therefore, our required allowance for loan losses. CoServ is required to make quarterly payments to us totaling $28 million each year as part of their restructured loan agreement. Currently, the application of the $28 million of payments to reduce the principal balance over the next 12 months results in a reduction of $21 million to the calculated impairment. In addition, CoServ’s effective rate utilized to calculate impairment on the loans outstanding from us has a variable-rate component. Based on CoServ’s current loan balance at May 31, 2010, an increase or decrease of 25 basis points to our short-term and long-term variable interest rates results in an increase or decrease of approximately $9 million, respectively, to the calculated impairment on loans irrespective of a change in the credit fundamentals for CoServ.

Deterioration in Collateral Value for Impaired Loans

During the years ended May 31, 2010 and 2009, we increased the specific reserve of our loan loss allowance by $44 million and $130 million, respectively, to reflect the estimated deterioration to the value of the operating companies comprising the collateral for our impaired loans to ICC. Our adjusted TIER would have been 1.16 and 1.26 for the years ended May 31, 2010 and 2009, respectively, without the deterioration to the estimated fair value of this collateral. We expect to acquire ICC’s assets during fiscal year 2011 as a result of bankruptcy proceedings and will report them as foreclosed assets on the consolidated balance sheet. Foreclosed assets are initially recorded at fair value and periodically reviewed for impairment. At this time, it is not possible to determine if future deterioration to the estimated fair value of these assets could result in the recognition of an impairment over the next 12 months.

Effect of Competition and Economic Recession on Loan Portfolio

Competition for our members’ lending business increased over the past year and affected our ability to grow or sustain loan volume and resulted in increased pressure on pricing considerations. In addition, the economic recession lowered demand for loan funds from our members, in part due to reluctance to commit to large capital projects.

Financial Condition

Outstanding Loan Balances

The primary reasons for the $850 million decline to loans outstanding during fiscal year 2010 were the approximately $460 million of repayments from power supply bridge loans with loan funds from RUS as anticipated, the general decline in construction of distribution infrastructure due to the economic downturn, the lower use of lines of credit from distribution members and the sale of $107 million in existing distribution loans to the Federal Agricultural Mortgage Corporation during the period. We advance loans to our power supply systems that request funding from RUS to provide financial support between the time the loan from RUS is requested and the time it is funded. These bridge loans will generally be outstanding for no longer than five years. We also established a program under which we facilitate the sale of loans we originate to the Federal Agriculture Mortgage Corporation which provides a lower cost option for our members as compared to the interest rates on our loans. All loans sold to the Federal Agricultural Mortgage Corporation are sold at par, and we retain the servicing rights. During fiscal year 2011, we expect our loan volume to decrease primarily due to anticipated RTFC loan prepayments and the settlement of ICC as the acquired assets will be reported as foreclosed assets. Our intention is to focus our lending on our electric systems while decreasing our telecommunications exposure through RTFC. We expect our electric loans to slightly decrease during fiscal year 2011 as a result of loan sales to other financial institutions.

Adjusted Debt to Equity Ratio

Our adjusted debt to equity ratio at May 31, 2010 was 5.93, a reduction from 6.59 at May 31, 2009. We took a number of steps over the past two years to lower our adjusted debt to equity ratio as described below. Our decrease to loans outstanding at May 31, 2010 also contributed to the decrease in the adjusted debt to equity ratio.

In November 2008, we began to offer member capital securities to our members, and since that time we sold approximately $398 million. Member capital securities are voluntary investments by members in our subordinated certificates with a 35-year maturity. The member capital securities were initially offered with an interest rate of 7.50 percent, and on January 1, 2010, the rate for new member capital securities was lowered to 5.00 percent. Member capital securities are callable at par at our option five years from the date of issuance and anytime thereafter. The member capital securities are subordinated to all other debt outstanding and are on par with all other forms of subordinated certificates. Member capital securities are classified as equity rather than debt in the adjusted debt to equity ratio.

In June 2009, CFC's Board of Directors approved a change in its patronage capital retirement guidelines. CFC now retires 50 percent of the prior year's net earnings allocated to members following the end of each fiscal year, which is a reduction from 70 percent. CFC holds the remaining 50 percent for 25 years, which represents an extension of the prior hold period of 15 years. This change to the retirement guidelines is expected to significantly increase retained equity over the next 10 years. CFC's Board of Directors must approve the annual allocation and retirement of patronage capital and may adjust these to increase or decrease the amount allocated or retired.

In July 2010, we provided the required call notice on our $125 million 6.75 percent subordinated deferrable debt securities due 2043. The $125 million of subordinated deferrable debt will be redeemed at par plus accrued and unpaid interest on September 1, 2010. Current market conditions will allow this subordinated deferrable debt to be refinanced at significantly lower interest rates that will reduce interest expense in future years, however there will be minimal interest savings in fiscal year 2011 due to the write-off of $4 million of unamortized issuance costs at the redemption date.

We expect that the efforts we have taken over the past few years to increase member investment in subordinated certificates and to adjust our patronage capital retirement policy will result in a greater retention of adjusted equity and, therefore, a lower adjusted debt to equity ratio. While the above actions and the anticipated decrease to loans outstanding help to lower the adjusted debt to equity ratio, the reduction is expected to be offset by an increase in the adjusted debt to equity ratio due to the redemption of the $125 million subordinated deferrable debt. In our adjusted debt to equity calculation, we consider the subordinated deferrable debt to be equity, as it has many equity-like characteristics, such as very long maturity, subordination to all other debt we issue other than members' subordinated certificates and our right to defer interest payments for up to five years. As a result, we anticipate that there will be a small increase in the adjusted debt to equity ratio at May 31, 2011 compared to May 31, 2010.

Liquidity

The investing community and rating agencies placed a premium on liquidity after the financial crisis in the fall of 2008. As mentioned above, some of the actions we took to mitigate liquidity concerns have been successful, but resulted in higher interest expense than we could have otherwise achieved. During the year ended May 31, 2010, we kept commercial paper issuance capacity in reserve by issuing longer term debt. As a result, our average balance of commercial paper outstanding during the year ended May 31, 2010 is substantially lower than in the prior year. Commercial paper provides our lowest cost variable-rate funding.

It is our belief that we have sufficient sources of liquidity to meet all debt refinancing and member loan needs over the next 12 to 18 month period.

We have long-term debt maturing in the next 12 months totaling $2,312 million at May 31, 2010. As presented in our projected sources and uses of liquidity chart on page 57, we believe over the next six quarters, our long-term advances will be approximately $64 million greater than the repayments on our long-term loans, which will increase the need for liquidity slightly over that period.

We expect that we have the market access to increase the use of commercial paper funding in fiscal year 2011. We use our bank line facilities as backup support for our commercial paper program. In March 2010, we replaced our 364-day $1,000 million revolving credit agreement with a $1,300 million three-year revolving credit agreement. Subsequent to the renewal, also in March 2010, we increased our available credit under the facility by $35 million to a total of $1,335 million. This new facility, along with our two five-year revolving credit agreements, now provides us with $3,351 million of liquidity support at May 31, 2010.

At May 31, 2010, we have $813 million available under our note purchase agreements with the Federal Agricultural Mortgage Corporation, subject to market conditions. We also expect to maintain the ability to obtain funding through the capital markets. We qualify as a well-known seasoned issuer and have effective registration statements on file with the Securities and Exchange Commission to issue an unlimited amount of collateral trust bonds, medium-term notes and member capital securities. From February 2009 through November 2009, we issued a significant amount of retail notes under our medium-term notes shelf registration statement. There has not been a need for us to obtain additional market funding since November 2009 and we have not posted retail notes for sale; however, we believe such market funding is available to us.

Critical Accounting Policies and Estimates

Our significant accounting principles, as described in Note 1, General Information and Accounting Polices, to the consolidated financial statements are essential in understanding Management’s Discussion and Analysis of Financial Condition and Results of Operations. Many of our significant accounting principles require complex judgments to estimate values of assets and liabilities. We have procedures and processes to facilitate making these judgments.

We identified the allowance for loan losses and the determination of fair value of certain items on our balance sheet as critical accounting policies because they require significant estimations and judgments by management. The more judgmental estimates are summarized below. We identified and described the development of the variables most important in the estimation process. In many cases, there are numerous alternative judgments that could be used in the process of determining the inputs required for estimation. Where alternatives exist, we used the factors we believe represent the most reasonable value in developing the inputs. Actual performance that differs from our estimates of the key variables could affect net income. Separate from the possible future effect to net income from our model inputs, market-sensitive assets and liabilities may change subsequent to the balance sheet date, often significantly, due to the nature and magnitude of future credit and market conditions. Such credit and market conditions may change quickly and in unforeseen ways, and the resulting volatility could have a significant, negative effect on future operating results.

Below is a description of the process used in determining the adequacy of the allowance for loan losses and the determination of fair value for certain items on our balance sheet.

Allowance for Loan Losses
At May 31, 2010 and 2009, our loan loss allowance totaled $593 million and $623 million, representing 3.07 percent and 3.09 percent 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. We calculate the loan 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. Management uses its best estimates, based upon available market data and/or projections of future cash flows. However, because of the subjective nature of these estimates, other estimates could be reasonable, and changes in the assumptions used and our estimates could have a material effect on our financial statements.

Impaired Loans
We calculate the impairment on loans based on GAAP. A loan is impaired when a creditor does not expect to collect all principal and interest due under the original terms of the loan, other than an insignificant delay or an insignificant shortfall in amount. We review our portfolio to identify indicators of impairment at least quarterly. 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 us and the borrower and
- estimates of the value of the borrower’s assets that have been pledged as collateral to secure our loans.

We calculate the impairment by comparing the recorded investment in the loan to the present value of the expected future cash flows associated with the loan discounted at the effective interest rate on the loans at the time the loans became impaired. If the current balance in the receivable is greater than the net present value of the future payments discounted at the effective interest rate at the time the loans became impaired, the impairment is equal to that difference. If it is not possible to estimate the future cash flows associated with a loan, the loan is collateral dependent or foreclosure is probable, then the impairment calculation is based on the fair value of the collateral for the loan.

At May 31, 2010 and 2009, there is a total specific loan loss allowance balance of $437 million and $414 million for impaired loans totaling $1,064 million and $1,056 million, respectively, representing 41 percent and 39 percent, respectively, of total impaired loans. The $437 million and $414 million specific loan loss allowance balance represented 74 percent and 66 percent of the total loan loss allowance at May 31, 2010 and 2009, respectively. For certain impaired loans at May 31, 2010 and 2009, the effective interest rate at the time of impairment included a variable-rate component. As a result, the calculated impairment for these loans increases or decreases with changes in short-term and long-term variable interest rates. Based on the current balance of impaired loans at May 31, 2010, a 25 basis point increase or decrease to our variable interest rates would result in an increase or decrease, respectively, of approximately $9 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 flows or collateral value are the key estimates made by management. Changes in the estimated future cash flows or collateral value affect the amount of the calculated impairment. The change in cash flows required to make the change in the calculated impairment material will be different for each borrower and depend on the period covered, the effective interest rate at the time the loans became impaired and the amount of the loan outstanding. Estimates are not used to determine our investment in the receivables or the discount rate since, in all cases, the investment is equal to the loan balance outstanding at the reporting date, and the discount rate is equal to the interest rate on the loans at the time the loans became impaired.

High Risk Loans
We define a loan exposure as high risk when:

- the borrower has a history of late payments;
- the borrower's financial results do not satisfy loan financial covenants;
- the borrower contacts us to discuss pending financial difficulties; or
- for some other reason, we believe the borrower's financial results could deteriorate resulting in an elevated potential for loss.

Our Corporate Credit Committee determines which loans to classify as high risk. The committee meets at least quarterly to review all loan facilities with an internal risk rating above a certain level.

The Corporate Credit Committee sets the required loss allowance for each borrower based on their facts and circumstances, such as:

- the borrower's financial condition;
- the borrower's payment history;
- our estimate of the collateral value;
- pending litigation, if any; and
- other factors.

This is a subjective exercise where the Corporate Credit Committee uses the available information, as well as an established set of criteria, to make its best estimate of the loss allowance. At any reporting date, the loss allowance 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;
- bankruptcy of the borrower;
- payment default on our loans; and
- other factors.

The borrowers in the high risk loans category will generally either move to the impaired loans category or back to the general portfolio within 12 to 24 months. At May 31, 2010 and 2009, the loss allowance was $3 million and $11 million for the $18 million and $30 million of exposure classified as high risk, representing coverage of 17 percent and 37 percent, respectively. The $3 million and $11 million loan loss allowance for the high risk loans category represented 0.5 percent and 2 percent of the total loan loss allowance at May 31, 2010 and 2009, respectively.

General Portfolio
The general portfolio of loans consists of all loans not specifically identified in the impaired or high risk categories. We determine the required loan loss allowance for the general portfolio by using our internal risk rating system, Standard & Poor's historical default data on corporate bonds and our specific loss recovery data. We use the following factors to determine the loan loss allowance for the general portfolio category:

- Internal risk ratings. We maintain risk ratings for each credit facility outstanding to our borrowers. The ratings are updated at least annually and are based on the following:
  - general financial condition of the borrower;
  - our estimated value of the collateral securing our loans;
  - our judgment of the borrower's management;

- our judgment of the borrower's competitive position within its service territory and industry;
- our estimate of the potential impact of proposed regulation and litigation; and
- other factors specific to individual borrowers or classes of borrowers.

- Standard corporate bond default table. The table provides expected default rates based on rating level and the remaining maturity of the bond. We use the standard default table for all corporate bonds published by Standard and Poor's Corporation to assist in estimating our loan loss allowance because we have limited history from which to develop loss expectations.
- Recovery rates. Estimated recovery rates based on historical experience of loan balance at the time of default compared with the total loss on the loan to date.

We aggregate the loans in the general portfolio by borrower type (distribution, power supply, telecommunications, associate and NCSC) and by internal risk rating within borrower type. We correlate our internal risk ratings to the ratings used in the standard default table for borrowers with ratings from Standard and Poor's Corporation and based on a standard matching used by banks.

At May 31, 2010 and 2009, we had a total of $18,019 million and $18,858 million of loans, respectively, in the general portfolio. This total excludes $237 million and $244 million of loans at May 31, 2010 and 2009, respectively, that have a U.S. government guarantee of all principal and interest payments. We do not maintain a loan loss allowance on loans that are guaranteed by the U.S. government. At May 31, 2010 and 2009, we have a total loss allowance of $122 million and $162 million, respectively, for loans in the general portfolio representing coverage of 0.7 percent and 0.9 percent, respectively, of the total loans for the general portfolio.

In addition to the loan loss allowance for the general portfolio as calculated above, we maintain an unallocated reserve to cover the additional risk associated with large loan exposures and to cover economic and environmental factors that may be currently affecting the financial results of borrowers, but have not materialized in the borrower's annual audited financial statements.

The first component of the unallocated reserve is a single obligor reserve to cover the additional risk related to large loan exposures. We set the exposure threshold at 1 percent of total loans and guarantees outstanding and provide coverage equal to 1 percent times the internal risk rating associated with the loan exposure. We believe this reflects our assessment of the additional risk related to large loan exposures. At May 31, 2010 and 2009, our single obligor reserve was $28 million and $30 million, respectively.

The second component of the unallocated reserve is an economic and environmental reserve to cover factors we believe are currently affecting the financial results of borrowers, but are not reflected in our internal risk rating process and, therefore, present an increased risk of losses incurred as of the balance sheet date. We use annual audited financial statements from our borrowers as part of our internal risk rating process. There could be a lag between the time various environmental and economic factors occur and the time when these factors are reflected in the annual audited financial statements of the borrower and therefore the internal risk rating we determine for the borrower. Our Corporate Credit Committee makes a quarterly determination of the percentage of general loan loss allowance to be held and the portions of the loan portfolio that the additional loan loss allowance percentage shall be applied. This reserve component may be set at up to 10 percent of the amount of the calculated general loan loss allowance for each type of loan exposure. At May 31, 2010, the Corporate Credit Committee set the economic and environmental component of the unallocated reserve to be $3 million, representing 2 percent of the general reserve held for electric and NCSC loans and 7 percent of the general reserve held for telecommunications loans. This amount took into consideration the effect on electric and telecommunications borrowers from (1) the current economic downturn, (2) the increase in the unemployment rate, (3) the decline in the housing market that led to a significant increase in foreclosures and, (4) specifically for telecommunications borrowers, reduced discretionary spending for telecommunications services, increased competition from wireless providers and continued loss of access lines among rural local exchange carriers. At May 31, 2009, the economic and environmental component of the unallocated loan loss allowance was $6 million representing 3.5 percent of the general reserve held for electric and NCSC loans and 5 percent of the general reserve held for telecommunications loans.

Senior management reviews the estimates and assumptions used in the calculations of the loan loss allowance for impaired loans, high risk loans, the general portfolio and the unallocated reserve 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 our 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.

Fair Value

We determined the accounting for certain items on our balance sheet at fair value to be a critical accounting policy because of the subjective nature and the requirement for management to make significant estimations in determining the amounts to be recorded. Different assumptions and estimates could also be reasonable, and changes in the assumptions used and estimates made could have a material effect on our financial statements.

The primary instruments recorded on our balance sheet at fair value are derivative financial instruments. Derivative instruments must be recorded on the balance sheet as either an asset or liability measured at fair value. Since these instruments generally do not qualify for hedge accounting, the accounting standards require that we record all changes in fair value through earnings. We record the change in the fair value of derivatives instruments, along with realized gains and losses from cash settlements, in the derivative gain (losses) line item of the consolidated statement of operations each reporting period.

Since there is not an active secondary market for the types of derivative instruments we use, we obtain market quotes from our dealer counterparties. The market quotes are based on the expected future cash flow and estimated yield curves. We perform our own analysis to confirm the values obtained from the counterparties. The counterparties estimate future interest rates as part of the quotes they provide to us. We adjust all derivatives to fair value on a quarterly basis. The fair value we record will change as estimates of future interest rates change. To estimate the impact of changes to interest rates on the forward value of derivatives, we would need to estimate all changes to interest rates through the maturity of our outstanding derivatives. The maturities of our derivatives in the current portfolio run through 2045. Since many of the derivative instruments we use for risk management have such long-dated maturities, the valuation of these derivatives may require extrapolation of market data that is subject to significant judgment. Accounting standards on fair value require that credit risk be considered in determining the market value of any asset or liability carried at fair value. We adjust the market values of our derivatives received from the counterparties based on our counterparties' and our credit spreads observed in the credit default swap market. The credit default swap levels represent the credit risk premium required by a market participant based on the available information related to the creditor.

In addition to the valuation associated with derivative financial instruments, we also present foreclosed assets at fair value when initially recorded on the balance sheet. Subsequently, foreclosed assets are periodically revised for impairment. Our foreclosed assets do not meet the criteria to be classified as held for sale. If an impairment loss is recognized on our foreclosed assets, the adjusted carrying amount of the foreclosed assets becomes the new cost basis. Restoration of any recognized impairment loss is prohibited under GAAP, even when the fair value of the foreclosed assets increases subsequent to our recognition of impairment.

In many instances the valuation of these assets are judgmental and dependent upon comparisons to similar assets or estimations of future cash flows that are expected to be generated by the underlying foreclosed properties. In both of these instances, management uses its best estimates, based upon available market data and/or projections of future cash flows. However, because of the subjective nature of these estimates, other estimates could be reasonable, and changes in the assumptions used and our estimates could have a material effect on our financial statements.

New Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board issued Accounting Standards Update, Fair Value Measurements and Disclosures, which requires new disclosures, and clarifies existing disclosure requirements, about fair value measurements. This accounting standard clarifies existing disclosure requirements regarding the level of disaggregation of fair value measurements and inputs, and valuation techniques and requires the disclosure of gross transfers in and out of Level 3 of the fair value hierarchy, effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years, with early adoption permitted. Our adoption of this portion of the accounting standard in the first quarter of fiscal year 2012 is not expected to have material impact on our financial position and results of operations. We adopted the portion of this standard related to separately disclosing transfers of instruments between Level 1 and Level 2 of the fair value hierarchy in the third quarter of fiscal year 2010.

In July 2010, the Financial Accounting Standards Board issued Accounting Standards Update, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses, which requires new disclosures, and clarifies existing disclosure requirements, for financing receivables, which includes loans, lease receivables, and other long-term receivables. Additional disclosures required include the aging of past due receivables, credit quality indicators, and modifications of financing receivables. The new guidance requires us to separately disaggregate new and existing disclosures based on how we develop our allowance for credit losses and how we manage credit exposures. The amendments that require disclosures as of the end of a reporting period are effective for interim and annual periods ending on or after December 15, 2010, which we will adopt in the third quarter of fiscal year 2011. The amendments that require disclosures about activity that occurs during a reporting period are effective for interim and annual periods beginning on or after December 15, 2010, which we will adopt in the fourth quarter of fiscal year 2011. Our adoption of this standard is not expected to have a material impact on our financial position or results of operations.

Results of Operations

Reclassifications of prior-period amounts for fiscal years 2009 and 2008 have been made to conform to the current reporting format for the following two items. Noncontrolling interest was reclassified to consolidated net income for the years ended May 31, 2009 and 2008 to comply with new accounting standards adopted on June 1, 2009. In addition, the derivative cash settlements and derivative forward value line items were combined and reported as derivative losses in the non-interest income section of the consolidated statement of operations to conform to the May 31, 2010 presentation.

The following table presents the results of operations for the years ended May 31, 2010, 2009 and 2008.

(dollar amounts in thousands)	For the year ended May 31,			Change from previous year	
	2010	2009	2008	2010 vs. 2009	2009 vs. 2008
Interest income	$ 1,043,635}	$ 1,070,764	$ 1,051,393	$ (27,129)	$ 19,371
Interest expense	(912,111)	(935,021)	(931,268)	22,910}	(3,753)
Net interest income	131,524}	135,743	120,125	(4,219)	15,618
Recovery of (provision for) loan losses	30,415}	(113,699)	30,262	144,114}	(143,961)
Net interest income after recovery of (provision for) loan losses	161,939}	22,044	150,387	139,895}	(128,343)
Non-interest income:					
Fee and other income	17,711}	13,163	19,608	4,548}	(6,445)
Settlement income	22,953}	-	-	22,953}	-
Derivative losses	(20,608)	(47,028)	(71,710)	26,420}	24,682
Results of operations from foreclosed assets	1,122}	3,774	7,528	(2,652)	(3,754)
Total non-interest income	21,178}	(30,091)	(44,574)	51,269}	14,483
Non-interest expense:					
Salaries and employee benefits	(39,113)	(36,865)	(36,428)	(2,248)	(437)
Other general and administrative expenses	(31,839)	(23,977)	(24,041)	(7,862)	64
Recovery of (provision for) guarantee liability	5,281}	(1,615)	3,104	6,896}	(4,719)
Market adjustment on foreclosed assets	(6,591)	(8,014)	(5,840)	1,423}	(2,174)
Loss on early extinguishment of debt	-}	-	(5,509)	-}	5,509
Other	(604)	(353)	(788)	(251)	435
Total non-interest expense	(72,866)	(70,824)	(69,502)	(2,042)	(1,322)
Income (loss) prior to income taxes	110,251}	(78,871)	36,311	189,122}	(115,182)
Income tax benefit	296}	5,101	3,335	(4,805)	1,766
Net income (loss)	110,547}	(73,770)	39,646	184,317}	(113,416)
Less: Net (income) loss attributable to noncontrolling interest	(235)	3,900	6,099	(4,135)	(2,199)
Net income (loss) attributable to CFC	$ 110,312}	$ (69,870)	$ 45,745	$ 180,182}	$ (115,615)
TIER (1)	1.12}	-	1.04		

Adjusted TIER (2)	1.12}	1.10	1.15

(1) For the year ended May 31, 2009, we reported a net loss of $74 million and, therefore, the TIER calculation for that period results in a value below 1.00.
(2) Adjusted to exclude the effect of the derivative forward value from net income and to include all derivative cash settlements in the interest expense. The derivative forward value and derivative cash settlements are combined in the derivative losses line item in the chart above. See Non-GAAP Financial Measures for further explanation and a reconciliation of these adjustments.

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

Average balances and interest rates – Assets

	Average volume			Interest income			Average yield		
(dollar amounts in thousands)	2010	2009	2008	2010	2009	2008	2010	2009	2008
Long-term fixed-rate loans (1)	$ 15,456,301}	$ 15,052,425	$ 14,782,141	$ 897,648}	$ 890,367	$ 872,488	5.81 %	5.92 %	5.90 %
Long-term variable-rate loans (1)	2,131,132}	2,255,538	1,803,553	78,518}	92,975	86,787	3.68	4.12	4.81
Short-term loans (1)	1,652,154}	1,895,563	1,310,313	56,055}	75,604	77,145	3.39	3.99	5.89
Non-performing loans	523,813}	495,014	504,310	-}	- -	-	-}	-	-
Total	19,763,400}	19,698,540	18,400,317	1,032,221}	1,058,946	1,036,420	5.22	5.38	5.63
Investments (2)	550,597}	489,228	234,831	5,245}	5,683	7,394	0.95	1.16	3.15
Fee income	-}	-	-	6,169}	6,135	7,579	-}	-	-
Total	$ 20,313,997}	$ 20,187,768	$ 18,635,148	$ 1,043,635}	$ 1,070,764	$ 1,051,393	5.14	5.30	5.64

(1) Interest income on loans to members.
(2) Interest income on the investment of cash, debt securities and equity securities.

Analysis of changes in interest income

(dollar amounts in thousands)	2010 vs. 2009 Change due to (3) Average volume (1)	Average rate (2)	Net change	2009 vs 2008 Change due to (3) Average volume (1)	Average rate (2)	Net change
Increase (decrease) in interest income:						
Long-term fixed-rate loans	$ 23,889}	$(16,608)	$ 7,281}	$ 15,952}	$ 1,927}	$ 17,879}
Long-term variable-rate loans	(5,128)	(9,329)	(14,457)	21,750}	(15,562)	6,188}
Short-term loans	(9,708)	(9,841)	(19,549)	34,457}	(35,998)	(1,541)
Total interest income on loans (4)	9,053}	(35,778)	(26,725)	72,159}	(49,633)	22,526}
Investments	713}	(1,151)	(438)	8,010}	(9,721)	(1,711)
Fee income	-}	34}	34}	-}	(1,444)	(1,444)
Total interest income (4)	9,766}	(36,895)	(27,129)	80,169}	(60,798)	19,371}

(1) Calculated using the following formula: (current period average balance – prior-year period average balance) x prior-year period average rate.
(2) Calculated using the following formula: (current period average rate – prior-year period average rate) x current period average balance.
(3) The net change attributable to the combined impact of volume and rate has been allocated to each in proportion to the absolute dollar amounts of change.
(4) Changes due to average volume and average rate represent a calculated amount and are not intended to sum.

During the year ended May 31, 2010, interest income decreased 3 percent compared to the prior-year period. The factors driving our interest income decrease during the year ended May 31, 2010 are the overall lower interest rate environment and pressure from competition. During the year ended May 31, 2009, interest income increased by $19 million, or 2 percent, compared to the prior-year period. The increase was due to a $1,298 million, or 7 percent, increase in average loan volume largely offset by a 25 basis point decline in the average yield earned on the portfolio due to lower variable interest rates. Additionally, non-accrual loans reduced interest income for both the current and prior-year periods.

The effect of changes to interest rates in the capital markets on our interest income is limited to a certain extent since 78 percent and 76 percent of our average loan balance was for long-term fixed-rate loans during fiscal years 2010 and 2009, respectively. The average long-term variable and short-term interest rates we offered for electric loans decreased 28 basis points and 38 basis points, respectively, for the year ended May 31, 2010 compared to the interest rates for the prior year. Since a high percentage of our loan portfolio was made up of long-term fixed-rate loans, the average yield on the loan portfolio during the year ended May 31, 2010 only decreased by 16 basis points compared to the prior-year period. Our average long-term variable and short-term interest rates on electric loans decreased 102 basis points and 148 basis points, respectively, during fiscal year 2009. Since a high percentage of our loan portfolio was made up of long-term fixed-rate loans, the average yield on the loan portfolio during the year ended May 31, 2009 only decreased 25 basis points compared to the prior-year period.

The average long-term fixed interest rates we offered on electric loans for the year ended May 31, 2010 decreased 74 basis points compared to the prior year. As a cost-based lender, we issue new loans with fixed rates based on our cost of debt at the time of the advance. The financial crisis beginning in September 2008 increased our cost of issuing new debt and, therefore, long-term fixed rates increased. As corporate spreads tightened during fiscal year 2010, we were able to lower our long-term fixed rates offered on new loans. The average long-term fixed interest rates we offered on electric loans during the year ended May 31, 2009 increased 62 basis points compared to the prior year.

A portion of the reduction in income, due to lower variable and fixed interest rates we charged on our loans during fiscal year 2010, is due to continued pressures from alternative sources of funding available to our members from RUS and CoBank, ACB. RUS, as a government agency, and CoBank, ACB, as a government-sponsored enterprise, generally have access to lower cost capital than all other competitors. Our members have the opportunity to consider other interest rate options at repricing, including refinancing with another lender. Furthermore, we developed and continue to offer attractively priced options for our members, such as the program under which we sell loans to the Federal Agricultural Mortgage Corporation at 100 percent of the principal amount while retaining the servicing rights. We expect to remain competitive with our interest rate pricing options by increasing the use of commercial paper, which is our lowest cost funding, in our funding mix in fiscal year 2011 as compared to the utilization over the past year.

At May 31, 2010, approximately 48 percent of the outstanding balance of our line of credit loans were priced at rates lower than our standard line of credit interest rates because of loan syndications and our need to competitively price these loans due to competition for the business. Of the line of credit loans priced lower than our standard rates at May 31, 2010, 32 percent were made as part of loan syndications where the pricing was agreed upon by all of the participating banks and is based on current market conditions rather than our cost of funding.

Our non-performing and restructured loans on non-accrual status continue to affect interest income for both the current and prior-year periods. The effect of non-accrual loans on interest income is included in the rate variance in the table above. Interest income was reduced as follows as a result of holding loans on non-accrual status:

	Reduction to interest income		
(dollar amounts in thousands)	2010	2009	2008
Electric	$ 23,822}	$ 26,421	$ 33,400}
Telecommunications	29,028}	29,817	33,492}
Total	$ 52,850}	$ 56,238	$ 66,892}

The restructured loan to CoServ is on non-accrual status, however the decrease to interest income is largely offset by the reduction to the calculated impairment due to the principal payments, which results in a reduction to the required loan loss provision or a recovery for the period. During the year ended May 31, 2010, CoServ made scheduled payments of $28 million, all of which were applied as a reduction to the loan principal balance and resulted in a reduction of $22 million to the calculated impairment.

Interest Expense

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

Average balances and interest rates - Liabilities

	Average volume			Interest expense			Average cost		
(dollar amounts in thousands)	2010	2009	2008 (7)	2010	2009	2008	2010	2009	2008 (7)
Commercial paper and bank bid notes (1) (2)	$ 2,099,916}	$ 3,188,189	$ 2,719,598	$ (7,489)	$ (58,688)	$ (122,786)	(0.36)%	(1.84)%	(4.51)%
Medium-term notes (1)	4,632,884}	5,278,445	5,115,940	(278,972)	(326,313)	(330,193)	(6.02)	(6.18)	(6.45)
Collateral trust bonds (1)	5,471,615}	5,232,731	4,880,885	(320,059)	(290,152)	(243,579)	(5.85)	(5.54)	(4.99)
Subordinated deferrable debt (1)	301,914}	294,592	301,771	(19,663)	(19,663)	(19,663)	(6.51)	(6.67)	(6.52)
Subordinated certificates (1)	1,750,077}	1,428,083	1,326,216	(79,391)	(55,330)	(48,717)	(4.54)	(3.87)	(3.67)

Long-term private debt (1)	4,656,934}	3,595,048	2,980,097	(184,958)	(164,306)	(151,694)	(3.97)	(4.57)	(5.09)
Total	18,913,340}	19,017,088	17,324,507	(890,532)	(914,452)	(916,632)	(4.71)	(4.81)	(5.29)
Debt issuance costs (3)	-}	-	-	(10,927)	(10,158)	(9,605)	-	-	-
Fee expense (4)	-}	-	-	(10,652)	(10,411)	(5,031)	-	-	-
Total	$ 18,913,340}	$ 19,017,088	$ 17,324,507	$ (912,111)	$ (935,021)	$ (931,268)	(4.82)	(4.92)	(5.38)
Derivative cash settlements (5)	$ 11,397,281}	$ 12,764,394	$ 13,055,651	$ (23,304)	$ 112,989	$ 27,033	(0.20) %	0.89} %	0.21} %
Adjusted interest expense (6)	18,913,340}	19,017,088	17,324,507	(935,415)	(822,032)	(904,235)	(4.95)	(4.32)	(5.22)

(1) Interest expense includes the amortization of discounts on debt.
(2) Average volume includes the daily liquidity fund.
(3) Interest expense includes amortization of all deferred charges related to debt issuances, principally underwriter's fees, legal fees, printing costs and comfort letter fees. Amortization is calculated on the effective interest method. Also includes issuance costs related to dealer commercial paper, which are recognized as incurred.
(4) Interest expense includes various fees related to funding activities, including fees paid to banks participating in our revolving credit agreements. Fees are recognized as incurred or amortized on a straight-line basis over the life of the respective agreement.
(5) For derivative cash settlements, average volume represents the average notional amount of derivative contracts outstanding, and the average cost represents the net difference between the average rate paid and the average rate received for cash settlements during the period.
(6) See Non-GAAP Financial Measures for further explanation of the adjustment we make in our financial analysis to include the derivative cash settlements in interest expense.
(7) Average volume for medium-term notes has been revised to correct an error. As a result, total average volume, the average cost for medium-term notes and the average cost in total have been revised accordingly.

Analysis of changes in interest expense

	2010 vs. 2009			2009 vs. 2008		
	Change due to (3)			Change due to (3)		
(dollar amounts in thousands)	Average volume (1)	Average rate (2)	Net change	Average volume (1) (7)	Average rate (2) (7)	Net change
(Increase) decrease in interest expense:						
Commercial paper and bank bid notes	$ 20,033}	$ 31,166}	$ 51,199}	$ (21,156)	$ 85,254}	$ 64,098}
Medium-term notes	39,909}	7,432}	47,341}	(10,488)	14,368}	3,880}
Collateral trust bonds	(13,246)	(16,661)	(29,907)	(17,559)	(29,014)	(46,573)
Subordinated deferrable debt	(489)	489}	-}	468}	(468)	-}
Subordinated certificates	(12,475)	(11,586)	(24,061)	(3,742)	(2,871)	(6,613)
Long-term private debt	(48,533)	27,881}	(20,652)	(31,303)	18,691}	(12,612)
Total interest expense on debt (4)	(14,801)	38,721}	23,920}	(83,780)	85,960}	2,180}
Debt issuance costs	-}	(769)	(769)	-	(553)	(553)
Fee expense	-}	(241)	(241)	-	(5,380)	(5,380)
Total interest expense (4)	(14,801)	37,711}	22,910}	(83,780)	80,027}	(3,753)
Derivative cash settlements (5)	$(12,102)	$(124,191)	$ (136,293)	$ (603)	$ 86,559	$ 85,956
Adjusted interest expense (6)	4,485}	(117,868)	(113,383)	(88,343)	170,546	82,203

(1) Calculated using the following formula: (current period average balance – prior-year period average balance) x prior-year period average rate.
(2) Calculated using the following formula: (current period average rate – prior-year period average rate) x current period average balance.
(3) The net change attributable to the combined impact of volume and rate has been allocated to each in proportion to the absolute dollar amounts of change.
(4) Changes due to average volume and average rate represent a calculated amount and are not intended to sum.
(5) For derivative cash settlements, variance due to average volume represents the change in derivative cash settlements that resulted from the change in the average notional amount of derivative contracts outstanding. Variance due to average rate represents the change in derivative cash settlements that resulted from the net difference between the average rate paid and the average rate received for interest rate swaps during the period.
(6) See Non-GAAP Financial Measures for further explanation of the adjustment we make in our financial analysis to include the derivative cash settlements in interest expense.
(7) Average volume for medium-term notes has been revised to correct an error. As a result, changes due to average volume and average rate for medium-term notes, total interest expense and total adjusted interest expense have been revised accordingly.

During the year ended May 31, 2010, interest expense decreased 2 percent compared with the prior-year period. The largest factors contributing to this decrease were the reduction in both the average volume and average interest rates on our commercial paper and medium-term notes and the lower average rates on our long-term private debt during the year ended May 31, 2010 compared with the same prior-year period.

The lower interest rate environment for variable-rate debt in the capital markets significantly decreased the average interest rate on commercial paper issued during the year ended May 31, 2010 compared with the prior-year period.

Although commercial paper is our lowest cost funding, we increased our term debt issuance during fiscal year 2010 to keep more commercial paper issuance capacity in reserve and help mitigate liquidity risk concerns in the capital markets. The lower average balance of commercial paper outstanding during the year ended May 31, 2010 tempered the reduction to interest expense we could have achieved by issuing more commercial paper during the period.

The average volume of medium-term notes decreased for the year ended May 31, 2010 mainly because of the maturity of $1,495 million of dealer medium-term notes in the first quarter of fiscal year 2010. Approximately $2,200 million of medium-term notes that matured during the year were primarily refinanced with collateral trust bond issuances totaling $500 million, notes issued to the Federal Agricultural Mortgage Corporation totaling $625 million and the issuance of $565 million of new member and retail medium-term notes. The weighted average interest rate for medium-term notes decreased due to the maturity of higher-rated dealer medium-term notes of $1,250 million issued at a fixed rate of 5.75 percent resulting in a larger percentage of retail notes included in the balance at May 31, 2010 issued at a weighted average interest rate of 4.17 percent.

The weighted average rate for long-term private placement debt decreased primarily due to the $625 million in notes issued to the Federal Agricultural Mortgage Corporation during fiscal year 2010 with a lower interest rate compared with other private placement debt in place, primarily funding under the Guaranteed Underwriter program of the U.S. Department of Agriculture which supports the Rural Economic Development Loan and Grant program.

Partially offsetting these decreases in interest expense were increases in average volume and the higher average interest rate for collateral trust bonds and subordinated certificates during the year ended May 31, 2010 compared to the prior-year period. We experienced a full year of higher interest expense during the current fiscal year from the 10.375 percent $1,000 million collateral trust bonds issued in October 2008 and the 7.50 percent member capital securities, which we started issuing in November 2008. Both 10.375 percent and 7.50 percent represent a significantly higher cost than our other sources of funding.

Interest expense increased by less than 1 percent in fiscal year 2009 compared to fiscal year 2008. This increase was due to the higher level of debt outstanding to fund loan growth partially offset by the 46 basis point decline in the overall cost of our debt. The decline in debt costs was primarily attributable to a decline in the cost of our short-term and variable-rate debt as a result of a lower interest rate environment compared to fiscal year 2008. The growth in debt outstanding was primarily attributed to amounts borrowed under the Guaranteed Underwriter program of the U.S. Department of Agriculture, notes payable issued to the Federal Agricultural Mortgage Corporation and new issuances of collateral trust bonds since May 31, 2008.

The adjusted interest expense, which includes all derivative cash settlements, was $935 million for the year ended May 31, 2010, compared to $822 million and $904 million for the years ended May 31, 2009 and 2008, respectively. The adjusted interest expense was higher during the year ended May 31, 2010 due partly to the decrease in cash settlement income as a result of a higher average rate paid on derivative instruments as discussed further below. The adjusted interest expense was lower during the year ended May 31, 2009 primarily due to the termination of swaps during fiscal year 2009 that resulted in a $97 million gain recognized as a cash settlement. These changes in derivative cash settlements were partially offset by the changes to interest expense noted above. See Non-GAAP Financial Measures for further explanation of the adjustment we make in our financial analysis to include all derivative cash settlements in interest expense.

Net Interest Income

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

Average interest rates – Assets and Liabilities

	For the year ended May 31,					
	2010	2009	2008	2010	2009	2008
(dollar amounts in thousands)	Interest income (expense)			Average yield (cost)		
Total interest income	$ 1,043,635}	$ 1,070,764}	$$ 1,051,393}	5.14}%	5.30}%	5.64}%
Total interest expense	(912,111)	(935,021)	(931,268)	(4.82)	(4.92)	(5.38)
Net interest income/Net yield (cost)	$ 131,524}	$ 135,743}	$$ 120,125}	0.32}%	0.38}%	0.26}%
Derivative cash settlements	(23,304)	112,989}	27,033}	(0.20)	0.89}	0.21}
Adjusted net interest income/Adjusted net yield (1)	108,220}	248,732}	147,158}	0.19}	0.98}	0.42}

(1) See Non-GAAP Financial Measures for further explanation of the adjustment we make in our financial analysis to include the derivative cash settlements in interest expense, which affects adjusted net interest income.

Analysis of changes in net interest income

	2010 vs. 2009			2009 vs. 2008		
	Change due to (3)			Change due to (3)		
(dollar amounts in thousands)	Average volume (1)	Average rate (2)	Net change	Average volume (1)	Average rate (2)	Net change

Increase (decrease) in net interest income	$ (5,035)	$ 816}	$ (4,219)	$(3,611)	$19,229	$ 15,618
Increase (decrease) in adjusted net interest income	14,251}	(154,763)	(140,512)	(8,174)	109,748	101,574

(1) Calculated using the following formula: (current period average balance – prior-year period average balance) x prior-year period average rate.
(2) Calculated using the following formula: (current period average rate – prior-year period average rate) x current period average balance.
(3) The net change attributable to the combined impact of volume and rate has been allocated to each in proportion to the absolute dollar amounts of change.

During the year ended May 31, 2010, the decrease in interest income due to the 16 basis point decline in the average yield of the loan portfolio was offset by the 10 basis point decrease in the overall cost of debt. As a result, net interest income decreased $4 million for the year ended May 31, 2010 compared with the prior-year period primarily due to issuing more term debt and relying less on lower-cost commercial paper. This change in the overall mix of funding was successful in mitigating liquidity risks, but prevented us from realizing the potential reduction to interest expense available through fully utilizing our commercial paper issuance authority in the current low interest rate environment.

The $16 million increase in net interest income for the year ended May 31, 2009 compared with the prior-year period was due primarily to:

- the 46 basis point decrease in the overall cost of debt, and
- the $1,298 million, or 7 percent, increase in average loan volume offset by
- the $1,693 million, or 10 percent, increase in the average debt volume due to the increase in average loan volume and the prefunding of maturing debt, and
- the 25 basis point decline in the yield of our loan portfolio.

The adjusted net interest income, which includes all derivative cash settlements, for the year ended May 31, 2010 was $108 million, a decrease compared to $249 million and $147 million for the years ended May 31, 2009 and 2008, respectively. Adjusted net interest income decreased during fiscal year 2010 and increased during fiscal year 2009 compared to the prior year periods primarily due to cash settlements income resulting from terminated interest rate swaps during fiscal year 2009 as discussed further below. See Non-GAAP Financial Measures for further explanation of the adjustment we make in our financial analysis to include all derivative cash settlements in determining our adjusted interest expense which, in turn, affects adjusted net interest income.

Recovery of/Provision for Loan Losses

The recovery of loan losses of $30 million for the year ended May 31, 2010 was primarily due to decreases of $40 million and $8 million to the reserves for our general and high risk portfolios, respectively, offset by a $23 million increase to the reserve for impaired borrowers. Additionally, there was a $5 million decrease to the unallocated reserve associated with large loan exposures, as well as economic and environmental factors that we are aware of, but are not yet reflected in the borrowers' annual audited financial statements. The decrease in the reserves for the general and high risk portfolios was driven by updated credit default information for corporate bonds obtained from Standard and Poor's Corporation, as well as improvement to the average internal risk rating for borrowers in the general portfolio and a reduction to loans outstanding in the general and high risk categories. The reserve for impaired loans increased $23 million during fiscal year 2010 due to a $44 million reduction in the estimated fair value of the collateral supporting our loan exposure to ICC and the addition of an impaired loan at May 31, 2010, partly offset by the $28 million decrease to the CoServ impairment due to payments received and the net decrease in our variable interest rates. See Non-performing Loans in the Financial Condition section for additional discussion on our non-performing loans. The decline in the fair value of the collateral supporting the ICC loans (also known as the Group 1 Assets) during fiscal year 2010 was principally driven by lower projected revenues for ICC's operations due to the economic recession and competition, as well as higher projected capital expenditures required for infrastructure investment.

We recorded a loan loss provision of $114 million for the year ended May 31, 2009, compared with a $30 million recovery for the prior-year period. The loan loss provision for the year ended May 31, 2009, was primarily due to a reduction in the fair value of the collateral supporting our exposure to ICC. The increase in the loan loss provision for ICC was partly offset by payments received and changes in estimates of future expected cash flows for certain other impaired loans.

Non-interest Income

Non-interest income increased by $51 million and $14 million for the years ended May 31, 2010 and 2009, respectively, compared with the prior-year periods. The primary reasons for the increases are the decreases of $26 million and $25 million to derivative losses for the years ended May 31, 2010 and 2009, respectively, compared with the same prior-year periods. Additionally, we recognized a one-time gain of $23 million during the year ended May 31, 2010 for the proceeds of a settlement with CoBank, ACB.

The derivative losses line item includes income and losses recorded for our interest rate swaps as summarized below for the year ended May 31:

(dollar amounts in thousands)	2010	2009	2008
Derivative cash settlements	$ (23,304)	$ 112,989	$ 27,033
Derivative forward value	2,696}	(160,017)	(98,743)
Derivative losses	$ (20,608)	$ (47,028)	$ (71,710)

The derivative forward value, which represents the change in fair value of our interest rate swaps during the reporting period, remained relatively flat during fiscal year 2010 as increases in the derivative forward value due to changes in the composition of our derivative portfolio were offset by decreases due to changes in expectations for interest rates. During the low interest rate environment of the past three years, our pay variable/receive fixed interest rate swaps had a higher fair value than our pay fixed/receive variable interest rate swaps. The percentage of our pay variable/receive fixed interest rate swaps to the overall portfolio increased to 50 percent at May 31, 2010 from 45 percent at May 31, 2009 and 41 percent at May 31, 2008. Derivative forward value gains due to a shift in the mix toward more pay variable/receive fixed interest rate swaps during fiscal year 2010 were minimized by changes in interest rate expectations at May 31, 2010 compared with estimates at May 31, 2009. The shift to a low interest rate environment during fiscal year 2009 and 2008 combined with the majority of our swaps being pay fixed/receive variable resulted in a lower estimated forward value during those periods. The derivative forward value during the year ended May 31, 2009 also includes the reversal of a $97 million derivative asset related to terminated interest rate swaps.

Cash settlements decreased during fiscal year 2010 compared to the prior-year period due to the $97 million of realized cash settlement income resulting from the terminations noted above. Additionally, the low interest rate environment, combined with the majority of our interest rate swaps being pay fixed/receive variable through the first half of fiscal year 2010, resulted in an average interest rate paid for cash settlements that was greater than the average interest rate received during fiscal year 2010. Cash settlements increased during fiscal year 2009 compared to the prior-year period due to the $97 million of realized cash settlement income, as well as income of $7 million representing the estimated recovery of a counterparty claim, partially offset by the affect of lower interest rates as we received a variable rate on the majority of our derivative contracts as noted above.

Non-interest income for the year ended May 31, 2010 was further affected by the $23 million one-time settlement gain from CoBank, ACB. On February 25, 2010, CoBank, ACB, agreed to a settlement related to our discovery that for a period of years, CoBank, ACB, employees improperly accessed confidential and proprietary information from our password-protected website for members. The settlement included a monetary payment of $23 million to us, as well as non-monetary commitments, including an agreement not to engage in the challenged conduct in the future. The settlement income is net of legal and other related expenses.

Non-interest Expense

The $2 million increase to non-interest expense for the year ended May 31, 2010 compared with the prior-year period was primarily due to the $2 million increase to salaries and employee benefits and $8 million increase to other general and administrative expenses, offset by the $5 million recovery of guarantee liability for the year ended May 31, 2010 compared with the $2 million provision for the prior-year period and the change in the fair value of foreclosed assets as described further below. The $8 million increase to other general and administrative expenses during the year ended May 31, 2010 was primarily due to the increase in legal fees and other expenses related to our effort to acquire the operating companies that comprise the collateral for our ICC loan exposure, including obtaining regulatory approvals. The $5 million recovery of guarantee liability is primarily due to the decrease of guarantees outstanding. Guarantees decreased by $104 million during the year ended May 31, 2010.

The $1 million increase to non-interest expense for the year ended May 31, 2009 compared with the prior-year period was primarily due to the $2 million provision for guarantee liability for the year ended May 31, 2009 compared to the $3 million recovery of guarantee liability for the prior year-end period and the $2 million increase in loss recorded to the fair value of foreclosed assets offset by the $6 million loss on early extinguishment of debt for the year ended May 31, 2008. The increase to the provision for guarantee liability during the year ended May 31, 2009 was primarily due to the $238 million increase in guarantees outstanding.

Non-interest expense for the years ended May 31, 2010, 2009 and 2008 included market adjustments on foreclosed assets of $7 million, $8 million and $6 million, respectively. The balance of foreclosed assets includes two land development loans and limited partnership interests in certain real estate developments for all periods presented. The collateral for both land development loans includes developed lots and land, raw land and underground mineral rights. During the years ended May 31, 2010, 2009 and 2008, the reduction to the fair value of the collateral supporting these land development loans was primarily due to residential home market weakness, which caused lot sales to slow down, and the troubled commercial real estate market. Additionally, in fiscal year 2009 lower natural gas prices, which influence the fair value of the mineral rights, resulted in a decrease in the fair value of the underlying collateral. At May 31, 2010, both land development loans were impaired and on non-accrual status.

Net Income (Loss)

The change in the items described above resulted in net income of $111 million for the year ended May 31, 2010. During the years ended May 31, 2009 and 2008, we had a net loss of $74 million and net income of $40 million, respectively. The adjusted net income, which excludes the effect of the derivative forward value, was $108 million, $86 million and $138 million for the years ended May 31, 2010, 2009 and 2008, respectively.

Noncontrolling Interest

Noncontrolling interest for the year ended May 31, 2010 represents $0.6 million of net loss for RTFC and $0.8 million of net income for NCSC compared with an RTFC net loss of $1 million, and $3 million of NCSC's total net loss of $9 million for the year ended May 31, 2009. During the year ended May 31, 2009, NCSC's net loss exceeded its equity balance by $6 million primarily due to NCSC's $12 million in derivative forward value losses during the period. Under prior accounting standards, CFC was required to absorb the excess NCSC loss. Based on the provisions of new accounting standards applied prospectively starting June 1, 2009, the noncontrolling interest is required to absorb the full amount of its losses, even if the losses exceed its equity balance. Noncontrolling interest net losses for the year ended May 31, 2008 of $0.3 million and $5.8 million for RTFC and NCSC, respectively, represented the total RTFC and NCSC net loss since noncontrolling interest losses did not exceed the related equity during that period.

Ratio of Earnings to Fixed Charges

The following table provides the calculation of the ratio of earnings to fixed charges. For the years ended May 31, 2010 and 2009, the fixed charge coverage ratio includes capitalized interest in total fixed charges, which is not included in our TIER calculation. For the year ended May 31, 2008, the ratio of earnings to fixed charges is the same calculation as TIER since we did not have any capitalized interest during that period. See Results of Operations for a discussion of TIER and adjustments that we make to the TIER calculation.

	For the year ended May 31,		
(dollar amounts in thousands)	2010	2009	2008
Income (loss) prior to cumulative effect of change in accounting principle	$ 110,547}	$ (73,770)	$ 39,646
Add: fixed charges	912,227}	935,194	931,268
Less: interest capitalized	(116)	(173)	-
Earnings available for fixed charges	$ 1,022,658}	$861,251	$ 970,914
Total fixed charges:			
Interest on all debt (including amortization of discount and issuance costs)	$ 912,111}	$935,021	$ 931,268
Interest capitalized	116}	173	-
Total fixed charges	$ 912,227}	$935,194	$ 931,268
Ratio of earnings to fixed charges (1)	1.12}	-	1.04

(1) For the year ended May 31, 2009, earnings were insufficient to cover fixed charges by $74 million.

Financial Condition

Loan and Guarantee Portfolio Assessment

Loan Programs

We are a cost-based lender that offers long-term fixed and variable-rate loans and short-term variable-rate loans. Borrowers choose between a variable interest rate or a fixed interest rate for periods of one to 35 years. When a selected fixed interest rate term expires, the borrower may select another fixed-rate term or the variable rate.

The following table summarizes loans outstanding by type and by segment at May 31:

(dollar amounts in millions)	2010		2009		2008		2007		2006	
Loans by type (1) (2):	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Long-term loans:										
Long-term fixed-rate loans	$ 15,413	80%	$ 14,602	73%	$ 15,205	80%	$ 14,663	81%	$ 14,547	79%
Long-term variable-rate loans	2,089	11	3,244	16	1,882	10	1,994	11	2,525	14
Loans guaranteed by RUS	237	1	244	1	250	1	256	1	261	1
Total long-term loans	17,739	92	18,090	90	17,337	91	16,913	93	17,333	94
Short-term loans	1,599	8	2,098	10	1,690	9	1,215	7	1,028	6
Total loans	$ 19,338	100%	$ 20,188	100%	$ 19,027	100%	$ 18,128	100%	$ 18,361	100%

Loans by segment (1):														
CFC:														
Distribution	$	13,459	70%	$	13,730	68%	$	13,438	71%	$	12,828	71%	$	12,859	70%
Power supply		3,770	19		4,268	21		3,339	17		2,858	16		2,811	15
Statewide and associate		86	-		93	1		109	1		119	1		125	1
CFC total		17,315	89		18,091	90		16,886	89		15,805	88		15,795	86
RTFC		1,672	9		1,680	8		1,727	9		1,860	10		2,162	12
NCSC		351	2		417	2		414	2		463	2		404	2
Total	$	19,338	100%	$	20,188	100%	$	19,027	100%	$	18,128	100%	$	18,361	100%

(1) Includes loans classified as restructured and non-performing.
(2) Loans are classified as long-term or short-term based on their original maturity.

Our loans outstanding decreased by $850 million, or 4 percent, for the year ended May 31, 2010. The primary reasons for this decline were the approximately $460 million of repayments from power supply bridge loans with loan funds from RUS as anticipated, the general decline in construction of distribution infrastructure lending due to the economic downturn, the lower use of lines of credit from distribution members and the sale of $107 million in existing distribution loans (the remaining $21 million of loan sales were for new advances) to the Federal Agricultural Mortgage Corporation during the period.

45

The percentage of long-term fixed-rate loans increased to 80 percent at May 31, 2010 from 73 percent at May 31, 2009 primarily due to loan interest rate conversions. Loans converting from a variable rate to a fixed rate for the year ended May 31, 2010 totaled $1,163 million, which was partially offset by loans that converted from a fixed rate to a variable rate totaling $341 million. The significant shift in variable-rate loans converting to fixed rates was the result of members taking advantage of historically low rates by locking down a fixed interest rate on their loans during the year ended May 31, 2010. As a result of lower costs to obtain funds in the capital markets during fiscal year 2010, the average long-term fixed rate offered on electric and telecommunications loans was 74 basis points and 195 basis points lower than the prior year, respectively. For the year ended May 31, 2009, loans converting from a fixed rate to variable rate totaled $856 million, which was partially offset by $205 million of loans that converted from a variable rate to a fixed rate.

The following table summarizes loans and guarantees outstanding by segment at May 31:

(dollar amounts in thousands)	2010		2009		Increase/
	Amount	% of Total	Amount	% of Total	(Decrease)
CFC:					
Distribution	$ 13,680,956}	67 %	$13,994,595	65%	$ (313,639)
Power supply	4,654,622}	22	5,213,868	24	(559,246)
Statewide and associate	108,214}	1	116,203	1	(7,989)
CFC total	18,443,792}	90	19,324,666	90	(880,874)
RTFC	1,672,529}	8	1,680,654	8	(8,125)
NCSC	393,193}	2	458,342	2	(65,149)
Total	$ 20,509,514}	100 %	$21,463,662	100%	$ (954,148)

Credit Concentration

CFC, RTFC and NCSC each have policies that limit the amount of credit that can be extended to individual borrowers or a controlled group of borrowers. The credit limitation policies cap the total exposure and unsecured exposure to the borrower based on an assessment of the borrower's risk profile and our internal risk rating system. As a member-owned cooperative lender, we balance the needs of our members and the risk associated with concentrations of credit exposure. The respective boards of directors must approve new credit requests from borrowers with total exposure or unsecured exposure in excess of the limits in the policies. Management may use syndicated credit arrangements to minimize credit concentrations.

The service territories of our electric and telecommunications members are located throughout the United States and its territories, including 49 states, the District of Columbia and two U.S. territories. At May 31, 2010 and 2009, loans outstanding to members in any one state or territory did not exceed 17 percent of total loans outstanding.

At May 31, 2010 and 2009, the total exposure outstanding to any one borrower or controlled group did not exceed 2.6 percent and 2.4 percent, respectively, of total loans and guarantees outstanding. At May 31, 2010 and 2009, the 10 largest borrowers included three distribution systems, six power supply systems and one telecommunications system. The following table shows the exposure to the 10 largest borrowers as a percentage of total exposure by type and by segment at May 31:

	2010		2009		Increase/
(dollar amounts in thousands)	Amount	% of Total	Amount	% of Total	(Decrease)
Total by type:					
Loans	$ 3,478,271}	17%	$ 3,686,956	17%	$ (208,685)

Guarantees	342,325}	2	363,883	2	(21,558)
Total credit exposure to 10 largest borrowers	$ 3,820,596}	19%	$ 4,050,839	19%	$ (230,243)
Total by segment:					
CFC	$ 3,274,247}	16%	$ 3,497,331	16%	$ (223,084)
RTFC	523,849}	3	523,758	3	91}
NCSC	22,500}	-	29,750	-	(7,250)
Total credit exposure to 10 largest borrowers	$ 3,820,596}	19%	$ 4,050,839	19%	$ (230,243)

Security Provisions

Except when providing short-term loans, we typically lend to our members on a senior secured basis. Long-term loans are typically secured on 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. Guarantee reimbursement obligations are typically secured on parity with other secured creditors by substantially all assets and revenues of the borrower or by the underlying financed asset. In addition to the collateral pledged to secure our loans, borrowers are also required to set rates charged to customers to achieve certain financial ratios.

The following table summarizes our unsecured credit exposure as a percentage of total exposure by type and by segment at May 31:

	2010		2009		Increase/
(dollar amounts in thousands)	Amount	% of Total	Amount	% of Total	(Decrease)
Total by type:					
Loans	$ 2,041,099}	10%	$ 2,831,111	13%	$ (790,012)
Guarantees	320,761}	2	347,325	2	(26,564)
Total unsecured credit exposure	$ 2,361,860}	12%	$ 3,178,436	15%	$ (816,576)
Total by segment:					
CFC	$ 2,049,365}	10%	$ 2,875,396	14%	$ (826,031)
RTFC	242,548}	2	237,259	1	5,289}
NCSC	69,947}	-	65,781	-	4,166}
Total unsecured credit exposure	$ 2,361,860}	12%	$ 3,178,436	15%	$ (816,576)

Pledging of Loans and Loans on Deposit

The following table summarizes our secured debt or debt requiring collateral on deposit, the excess collateral pledged and our unencumbered loans at May 31:

(dollar amounts in thousands)	2010	2009
Total loans to members	$ 19,338,405}	$ 20,188,207
Less: Total secured debt or debt requiring collateral on deposit (1)	(10,094,301)	(9,390,000)
Less: Excess collateral pledged or on deposit (2)	(1,834,358)	(2,566,723)
Unencumbered loans	$ 7,409,746}	$ 8,231,484
Unencumbered loans as a percentage of total loans	38%	41%

(1) Excludes debt secured by cash collateral only.

(2) Excludes cash collateral pledged to secure debt. Unless and until there is an event of default, we can withdraw excess collateral as long as there is 100 percent coverage of the secured debt. If there is an event of default under most of our indentures, we can only withdraw this excess collateral if we substitute cash of equal value.

We are required to pledge collateral equal to at least 100 percent of the outstanding balance of debt issued under our collateral trust bond indentures and note purchase agreements with the Federal Agricultural Mortgage Corporation. We pledge distribution mortgage loans and permitted investments under our collateral trust bond indentures. We pledge distribution and power supply mortgage loans under the note purchase agreements with Federal Agricultural Mortgage Corporation, which permit up to 20 percent of loans pledged to be from power supply systems. In addition, we are required to maintain collateral on deposit equal to at least 100 percent of the outstanding balance of debt under the Guaranteed Underwriter program of the U.S. Department of Agriculture which supports the Rural Economic Development Loan and Grant program, for which distribution and power supply loans may be deposited.

Although not required, we typically maintain pledged collateral and collateral on deposit in excess of the required 100 percent of the outstanding balance of debt issued. However, our revolving credit agreements limit pledged collateral to 150 percent of the outstanding balance of debt issued. The excess collateral ensures that required collateral levels are maintained and, when an opportunity exists, facilitates timely execution of debt issuances by limiting or eliminating the lead time required to gather collateral. Collateral levels fluctuate because:

- distribution and power supply loans typically amortize, while the debt issued under secured indentures and agreements have bullet maturities;
- individual loans may become ineligible for various reasons, some of which may be temporary; and
- distribution and power supply borrowers have the ability to prepay their loans.

We may request the return of collateral pledged or held on deposit in excess of the 100 percent of the principal balance requirement or may move the collateral from one program to another to facilitate a new debt issuance, provided that all conditions of eligibility under the different programs are satisfied.

The $3,000 million of notes payable to the Federal Financing Bank at May 31, 2010 and 2009 contain a rating trigger related to our senior secured credit ratings from Standard & Poor's Corporation, Moody's Investors Service and Fitch Ratings. A rating trigger event exists if our senior secured debt does not have at least two of the following ratings: (i) A- or higher from Standard & Poor's Corporation, (ii) A3 or higher from Moody's Investors Service, (iii) A- or higher from Fitch Ratings and (iv) an equivalent rating from a successor rating agency to any of the above rating agencies. If our senior secured credit ratings fall below the levels listed above, the mortgage notes on deposit at that time, which totaled $3,560 million at May 31, 2010, would be pledged as collateral rather than held on deposit. At May 31, 2010, our senior secured debt ratings from

Standard & Poor's Corporation, Moody's Investors Service, and Fitch Ratings were A+, A1, and A, respectively. At May 31, 2010, Standard & Poor's Corporation had our ratings on negative outlook, while Moody's Investors Service and Fitch Ratings had our ratings on stable outlook. Our ratings contract with Fitch Ratings expired on May 31, 2010 and was not subsequently renewed. As a result, subsequent to May 31, 2010, a rating trigger will occur if our senior secured credit ratings from either Standard & Poor's Corporation or Moody's Investors Service fall below the required threshold.

Non-performing and Restructured Loans

The following table presents a summary of non-performing and restructured loans as a percentage of total loans and total loans and guarantees outstanding at May 31:

(dollar amounts in thousands)	2010	2009	2008	2007	2006
Non-performing loans (1)	$ 560,527	$ 523,758	$ 506,864	$ 501,864	$ 577,869
Percent of loans outstanding	2.90%	2.59%	2.67%	2.77%	3.15%
Percent of loans and guarantees outstanding	2.73	2.44	2.52	2.61	2.97
Restructured loans	$ 508,044	$ 537,587	$ 577,111	$ 603,305	$ 630,354
Percent of loans outstanding	2.63%	2.66%	3.03%	3.33%	3.43%
Percent of loans and guarantees outstanding	2.48	2.50	2.88	3.14	3.24
Total non-performing and restructured loans	$ 1,068,571	$1,061,345	$1,083,975	$1,105,169	$1,208,223
Percent of loans outstanding	5.53%	5.25%	5.70%	6.10%	6.58%
Percent of loans and guarantees outstanding	5.21	4.94	5.40	5.75	6.21
Total non-accrual loans	$ 1,022,924	$1,014,585	$1,026,121	$1,046,561	$1,147,009
Percent of loans outstanding	5.29%	5.03%	5.39%	5.77%	6.25%
Percent of loans and guarantees outstanding	4.99	4.73	5.11	5.45	5.90

(1) All loans classified as non-performing were on non-accrual status.

We monitor our borrowers' performance and contact borrowers when payments are delinquent. The table below shows our delinquency rates for the past five years ended May 31, 2010. This table separately presents the delinquency rates including and excluding our non-performing loans to ICC. The ICC loans represent the vast majority of our delinquent loans, and we are in the process of acquiring the assets of this borrower as a result of bankruptcy proceedings.

(dollar amounts in thousands)	2010	2009	2008	2007	2006
Total loans outstanding	$ 19,338,405	$20,188,207	$19,026,995	$18,128,207	$18,360,905
Total number of delinquent borrowers	2	1	3	2	3
Loans outstanding for delinquent borrowers:					
Loans > 30 and < 90 days past due	$ 24,500	$ -	$ -	$ -	$ -
Loans > 90 days past due	536,027	523,758	506,864	501,864	577,868
ICC	536,027	523,758	491,706	492,795	488,392
Delinquency rates:					
Loans > 30 and < 90 days past due	0.13%	-%	-%	-%	-%
Loans > 90 days past due	2.77	2.59	2.66	2.77	3.15

Delinquency rates less ICC:					
Loans > 30 and < 90 days past due	0.13%	-%	-%	-%	-%
Loans > 90 days past due	-	-	0.08	0.05	0.49

A borrower is classified as non-performing when any one of the following criteria is met:

- principal or interest payments on any loan to the borrower are past due 90 days or more;
- as a result of court proceedings, repayment on the original terms is not anticipated; or
- for some other reason, management does not expect the timely repayment of principal and interest.

Once a borrower is classified as non-performing, we typically place the loan on non-accrual status and reverse all accrued and unpaid interest back to the date of the last payment. At May 31, 2010 and 2009, we had non-performing loans outstanding totaling $561 million to two borrowers and $524 million to one borrower, respectively. At May 31, 2010 and 2009, non-performing loans included $536 million and $524 million to ICC, respectively. The remaining $25 million of non-performing loans outstanding at May 31, 2010 was to one borrower that was put on non-accrual status on April 1, 2010. All loans classified as non-performing were on non-accrual status with respect to the recognition of interest income.

RTFC is the primary secured lender to ICC. All loans to ICC have been on non-accrual status since February 1, 2005. ICC has not made debt service payments to us since June 2005.

In February 2006, involuntary bankruptcy petitions were filed against:

- ICC's indirect majority shareholder and former chairman, Jeffrey Prosser;
- ICC's immediate parent, Emerging Communications, Inc.; and
- Emerging Communications, Inc.'s parent, Innovative Communication Company LLC.

In April 2006, RTFC reached a settlement with the following parties:

- ICC;
- Virgin Islands Telephone Corporation;
- Innovative Communication Company, LLC;
- Emerging Communications, Inc.;
- the directors of each of the above-listed entities; and
- Jeffrey Prosser.

Under the settlement, RTFC obtained judgments in the District Court of the Virgin Islands against ICC for approximately $525 million and Jeffrey Prosser for approximately $100 million. RTFC also obtained dismissals with prejudice and releases of all counterclaims, affirmative defenses and other lawsuits alleging wrongful acts by RTFC, certain of its officers and CFC, thereby resolving all the loan-related litigation in RTFC's favor. Regardless, Jeffrey Prosser and related parties continue to assert claims against CFC and certain of its officers and directors and other parties in various proceedings and forums. CFC therefore anticipates that it will continue to be engaged in defense of those assertions on many fronts, as well as pursuing claims of its own.

Innovative Communication Company LLC, Emerging Communications, Inc., ICC and Jeffrey Prosser each have bankruptcy proceedings pending in the United States District Court for the Virgin Islands, Bankruptcy Division. A Chapter 11 trustee has been appointed for each of the corporate estates; and a Chapter 7 trustee was appointed in Jeffrey Prosser's individual case. The Chapter 11 trustee of ICC has assumed ownership and control of ICC, including its subsidiaries.

On February 1, 2008, the bankruptcy court approved a motion of the Chapter 11 trustee of ICC to sell substantially all of ICC's assets, divided into three groups:

- Group 1 consisting of ICC assets and stock in ICC subsidiaries operating in the United States Virgin Islands, the British Virgin Islands and St. Maarten (the "Group 1 Assets");
- Group 2 consisting of stock in ICC subsidiaries operating in France and certain of its Caribbean territories (these assets were sold in December 2008); and
- Group 3 consisting of the newspaper operations of ICC (these assets were sold in May 2008).

Certain ancillary assets have also been sold including aircraft, art and real estate. In each instance, the distribution of proceeds was approved by the bankruptcy court and resulted in a net recovery to us.

On March 13, 2009, RTFC and the Chapter 11 trustee entered into a Purchase Agreement as part of a $250 million credit bid for the ICC Group 1 Assets. The Purchase Agreement is conditional upon the approval of the bankruptcy court and applicable regulators. On April 9, 2009, the U.S. bankruptcy court approved, on an interim basis, the sale of the ICC Group 1 Assets to RTFC, with RTFC reserving the right to assign its rights under the Purchase Agreement to CFC or its subsidiaries.

For total consideration of $30 million, in three purchase transactions occurring in May 2009, October 2009 and April 2010, RTFC acquired 100 percent of the 85,000 outstanding shares of Virgin Islands Telephone Corporation d/b/a Innovative Telephone preferred stock, including approximately $12.5 million in accrued and unpaid dividends. In

2004, the stock originally sold for $85 million. We believe that the acquisition of the preferred stock at a discount enhances our estimated recovery from the collateral.

In October 2009, the British Virgin Islands regulatory approval process was successfully completed, and in December 2009, the Federal Communications Commission approval was granted. On January 13, 2010, the Netherlands Antilles granted unconditional consent for CFC to acquire the St. Maarten assets. CFC obtained approval of a transfer of control from the Public Services Commission of the United States Virgin Islands on May 5, 2010. The Chapter 11 trustee and CFC requested authorization from the U.S. bankruptcy court to consummate the transfer of ownership of the Group 1 Assets to designated subsidiaries of CFC. This final sale hearing was conducted during the week of July 7, 2010 in St. Croix, United States Virgin Islands. The U.S. bankruptcy court issued its order on August 17, 2010 approving the Trustee's sale of the Group 1 Assets to designated subsidiaries of CFC. On August 17, 2010, the Superior Court of the Virgin Islands issued a stay of the Public Services Commission's Order approving the transfer, and scheduled a status conference for September 7, 2010.

Based on our analysis, we believe we have an adequate loan loss allowance for our exposure to ICC at May 31, 2010.

At May 31, 2010 and 2009, restructured loans totaled $508 million and $538 million, respectively, all of which were performing according to the restructure agreements. When agreements are executed to change the original terms of a loan, generally a change to the originally scheduled cash flows, we classify the loan as restructured unless the new terms are deemed to be market terms. We make a determination about the accrual of interest income for these loans on a loan-by-loan basis. The initial decision is based on the terms of the restructure agreement and the anticipated performance of the borrower over the term of the agreement. We periodically review the decision whether or not to accrue interest income on restructured loans based on the borrower's past performance and current financial condition. Approximately $3 million and $4 million of interest income was accrued on restructured loans during the years ended May 31, 2010 and 2009, respectively.

At May 31, 2010 and 2009, $462 million and $491 million, respectively, of total restructured loans are those for which we have not been accruing interest (non-accrual status). All restructured loans on non-accrual status were outstanding to CoServ and have been on non-accrual status since January 1, 2001. During the year ended May 31, 2010, CoServ made scheduled payments of $28 million, all of which were applied as a reduction to the loan principal balance and resulted in a reduction of $22 million to the calculated impairment. There has been no principal written off on the exposure to CoServ. In addition, $20 million of performing loans were outstanding under the capital expenditure loan facility at May 31, 2010 and 2009. Total loans to CoServ at May 31, 2010 and 2009, represented 2.4 percent of our total loans and guarantees outstanding.

Under the terms of a bankruptcy settlement from 2002, we restructured the loans to CoServ. CoServ is scheduled to make quarterly payments to us through December 2037. As part of the restructuring, we may be obligated to provide up to $204 million of senior secured capital expenditure loans to CoServ for electric distribution infrastructure through December 2012. Under the facility, advances are limited to $46 million per year. As of the date of this filing, there is $138 million available under this loan facility. When CoServ requests capital expenditure loans under this facility, these loans are made at the standard terms offered to all borrowers and require debt service payments in addition to the quarterly payments that CoServ is required to make on the restructured loan. To date, CoServ has made all payments required under the restructure agreement and capital expenditure loan facility. Under the terms of the restructure agreement, CoServ has the option to prepay the loan for the lesser of their outstanding balance or $405 million plus an interest payment true-up on or after December 13, 2008. To date, we have not received notice from CoServ that it intends to prepay the loan.

Based on our analysis, we believe we have an adequate loan loss allowance for our exposure to CoServ at May 31, 2010.

Allowance for Loan Losses

We maintain an allowance for loan losses at a level estimated by management to provide adequately for probable losses inherent in the loan portfolio. The allowance for loan losses is determined based upon evaluation of the loan portfolio, past loss experience, specific problem loans, economic conditions and other pertinent factors that, in management's judgment, could affect the risk of loss in the loan portfolio. We review and adjust the allowance quarterly to cover estimated probable losses in the portfolio.

Management makes recommendations to our Board of Directors regarding charge-offs of loan balances. In making its recommendation to charge off all or a portion of a loan balance, management considers various factors including cash flows and the collateral securing the loan. Since our inception in 1969, charge-offs totaled $218 million and recoveries totaled $35 million for a total net charge-off of $183 million. Management believes the allowance for loan losses is adequate to cover estimated probable portfolio losses.

Activity in the allowance for loan losses is summarized below:

	As of and for the year ended May 31,				
(dollar amounts in thousands)	2010	2009	2008	2007	2006
Beginning balance	$ 622,960}	$514,906	$561,663	$611,443	$589,749
Provision for (recovery of) loan losses	(30,415)	113,699	(30,262)	(6,922)	23,240
Net recoveries (charge-offs)	219}	(5,645)	(16,495)	(42,858)	(1,546)
Ending balance	$ 592,764}	$622,960	$514,906	$561,663	$611,443

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