

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORP /DC/  
Form 10-Q  
January 12, 2007

FORM 10-Q

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

X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the Quarterly Period Ended November 30, 2006

OR

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

Commission File Number 1-7102

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION  
(Exact name of registrant as specified in its charter)

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

52-0891669  
(I.R.S. Employer  
Identification No.)

Woodland Park, 2201 Cooperative Way, Herndon, VA 20171-3025  
(Address of principal executive offices)

Registrant's telephone number, including the area code (703) 709-6700

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The Registrant has no outstanding stock.



PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONSOLIDATED BALANCE SHEETS  
(UNAUDITED)  
(in thousands)

A S S E T S

	November 30, 2006	May 31, 2006
Cash and cash equivalents	\$ 101,517	\$ 260,338
Loans to members	18,157,506	18,360,905
Less: Allowance for loan losses	(611,358)	(611,443)
Loans to members, net	17,546,148	17,749,462
Accrued interest and other receivables	321,613	313,796
Fixed assets, net	5,374	6,146
Debt service reserve funds	80,159	80,159
Bond issuance costs, net	43,599	51,064
Foreclosed assets	69,562	120,889
Derivative assets	452,268	579,237
Other assets	18,106	18,530
	\$ 18,638,346	\$ 19,179,621

See accompanying notes.

## NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONSOLIDATED BALANCE SHEETS  
(UNAUDITED)  
(in thousands)

LIABILITIES AND EQUITY

	November 30, 2006	May 31, 2006
Short-term debt	\$ 5,193,134	\$ 5,343,824
Accrued interest payable	320,100	299,391
Long-term debt	10,396,740	10,642,028
Deferred income	31,696	40,086
Guarantee liability	18,725	16,750
Other liabilities	31,783	28,074
Derivative liabilities	101,737	85,198
Subordinated deferrable debt	486,440	486,440
Members' subordinated certificates:		
Membership subordinated certificates	650,871	650,799
Loan and guarantee subordinated certificates	775,210	777,161
Total members' subordinated certificates	1,426,081	1,427,960
Commitments and contingencies		
Minority interest	21,322	21,894
Equity:		
Retained equity	597,882	774,768
Accumulated other comprehensive income	12,706	13,208
Total equity	610,588	787,976
	\$ 18,638,346	\$ 19,179,621

See accompanying notes.

## NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)  
(in thousands)

For the Three and Six Months Ended November 30, 2006 and 2005

	Three months ended November 30,		Six months ended November 30,	
	2006	2005	2006	2005
Interest income	\$ 260,244	\$ 243,326	\$ 524,933	\$ 493,203
Interest expense	(245,261)	(236,093)	(497,716)	(471,370)
Net interest income	14,983	7,233	27,217	21,833
Provision for loan losses	-	(3,886)	-	(3,886)
Net interest income after provision for loan losses	14,983	3,347	27,217	17,947
Non-interest income:				
Rental and other income	308	13	625	1,475
Derivative cash settlements	13,163	16,816	24,869	37,016
Results of operations of foreclosed assets	2,989	3,878	5,991	8,570
Gain on sale of building and land	-	37,740	-	37,740
Total non-interest income	16,460	58,447	31,485	84,801
Non-interest expense:				
Salaries and employee benefits	(8,209)	(7,766)	(16,761)	(15,836)
Other general and administrative expenses	(4,568)	(4,985)	(8,744)	(9,032)
(Provision for) recovery of guarantee liability	(1,800)	(700)	(400)	2,600
Derivative forward value	(49,080)	(15,716)	(109,534)	(50,605)
Foreign currency adjustments	(20,620)	35,739	(17,299)	34,479
Total non-interest expense	(84,277)	6,572	(152,738)	(38,394)
(Loss) income prior to income taxes and minority interest	(52,834)	68,366	(94,036)	64,354
Income taxes	486	(1,530)	1,200	(1,729)
(Loss) income prior to minority interest	(52,348)	66,836	(92,836)	62,625

Minority interest	312	(3,107)	678	(4,213)
Net (loss) income	\$ (52,036)	\$ 63,729	\$ (92,158)	\$ 58,412

See accompanying notes.

## NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

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

For the Six Months Ended November 30, 2006 and 2005

	Total	Accumulated Other Comprehensive Income (Loss)	Subtotal Retained Membership Equity	Fees	Net Income	Unallocated Education Fund	Members' Capital Reserve	Patronage Capital Allocated	
								General Reserve Fund	Other
Six months ended November 30, 2006:									
Balance as of May 31, 2006	\$787,976	\$ 13,208	\$774,768	\$ 994	\$229,417	\$1,281	\$156,844	\$497	\$385,735
Patronage capital retirement	(84,247)	-	(84,247)	-	-	-	-	-	(84,247)
Loss prior to income taxes and minority interest	(94,036)	-	(94,036)	-	(94,036)	-	-	-	-
Accumulated other comprehensive loss	(502)	(502)	-	-	-	-	-	-	-
Income taxes	1,200	-	1,200	-	1,200	-	-	-	-
Minority interest	678	-	678	-	678	-	-	-	-
Other	(481)	-	(481)	(1)	-	(480)	-	-	-
Balance as of November 30, 2006	\$610,588	\$ 12,706	\$597,882	\$ 993	\$137,259	\$ 801	\$156,844	\$497	\$301,488
Six months ended November 30, 2005:									
Balance as of May 31, 2005	\$768,761	\$ 16,129	\$752,632	\$ 993	\$229,049	\$1,200	\$164,067	\$497	\$356,826
Patronage capital retirement	(72,912)	-	(72,912)	-	-	-	-	-	(72,912)
Income prior to income taxes and minority interest	64,354	-	64,354	-	64,354	-	-	-	-
Accumulated other comprehensive loss	(1,174)	(1,174)	-	-	-	-	-	-	-
Income taxes	(1,729)	-	(1,729)	-	(1,729)	-	-	-	-
Minority interest	(4,213)	-	(4,213)	-	(4,213)	-	-	-	-

Other	(434)	-	(434)	-	-	(434)	(30)	-	30
Balance as of November 30, 2005	\$752,653	\$ 14,955	\$737,698	\$ 993	\$287,461	\$ 766	\$164,037	\$497	\$283,944

See accompanying notes.



## NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

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

For the Six Months Ended November 30, 2006 and 2005

	2006	2005
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net (loss) income	\$ (92,158)	\$ 58,412
Add (deduct):		
Amortization of deferred income	(7,840)	(7,239)
Amortization of bond issuance costs and deferred charges	9,510	5,963
Depreciation	1,105	1,073
Provision for loan losses	-	3,886
Provision for (recovery of) guarantee liability	400	(2,600)
Results of operations of foreclosed assets	(5,991)	(8,570)
Derivative forward value	109,534	50,605
Foreign currency adjustments	17,299	(34,479)
Gain on sale of building and land	-	(37,740)
Changes in operating assets and liabilities:		
Accrued interest and other receivables	(11,085)	(9,270)
Accrued interest payable	20,709	34,400
Other	(6,271)	(183)
Net cash provided by operating activities	35,212	54,258
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Advances made on loans	(3,347,118)	(2,517,190)
Principal collected on loans	3,550,432	3,338,879
Net investment in fixed assets	(333)	(3,730)
Net cash provided by foreclosed assets	56,831	1,348
Net proceeds from sale of foreclosed assets	487	28,782
Net proceeds from sale of building and land	-	77,428
Net cash provided by investing activities	260,299	925,517
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from issuance (repayments) of short-term debt, net	136,133	(2,038,947)
Proceeds from issuance of long-term debt, net	111,154	1,132,055
Payments for retirement of long-term debt	(478,913)	(166,750)
Payments for retirement of subordinated deferrable debt	(150,000)	-
Proceeds from issuance of members' subordinated certificates	18,710	27,030
Payments for retirement of members' subordinated certificates	(17,322)	(71,427)
Payments for retirement of patronage capital	(74,094)	(57,328)
Net cash used in financing activities	(454,332)	(1,175,367)
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(158,821)</b>	<b>(195,592)</b>

BEGINNING CASH AND CASH EQUIVALENTS	260,338	418,514
ENDING CASH AND CASH EQUIVALENTS	\$ 101,517	\$ 222,922

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

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

For the Six Months Ended November 30, 2006 and 2005

	2006	2005
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest	\$ 467,498	\$ 416,172
Non-cash financing and investing activities:		
Patronage capital applied against loan balances	\$ -	\$ 1,829
Minority interest patronage capital applied against loan balances	-	1,689

See accompanying notes.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

(1) General Information and Accounting Policies

(a) General Information

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

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

National Cooperative Services Corporation ("NCSC") was incorporated in 1981 in the District of Columbia as a private cooperative association. The principal purpose of NCSC is to provide financing to the for-profit or non-profit entities that are owned, operated or controlled by or provide substantial benefit to, members of CFC. NCSC also markets, through its cooperative members, a consumer loan program for home improvements and an affinity credit card program. NCSC's membership consists of CFC and distribution systems that are members of CFC or are eligible for such membership. NCSC's results of operations and financial condition are consolidated with those of CFC in the accompanying financial statements. NCSC is headquartered with CFC in Herndon, Virginia. NCSC is a taxable corporation.

The Company's consolidated membership was 1,545 as of November 30, 2006 including 898 utility members, the majority of which are consumer-owned electric cooperatives, 514 telecommunications members, 66 service members and 67 associates in 49 states, the District of Columbia and two U.S. territories. The utility members included 829 distribution systems and 69 generation and transmission ("power supply") systems. Memberships among CFC, RTFC and NCSC have been eliminated in consolidation. All references to members within this document include members and associates.

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

These interim unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2006.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States ("GAAP") requires management to make estimates and assumptions that affect the assets, liabilities, revenues and expenses reported in the financial statements, as well as amounts included in the notes thereto, including discussion and disclosure of contingent liabilities. While the Company uses its best estimates and judgments based on the known facts at the date of the financial statements, actual results could differ from these estimates as future events occur.

The Company does not believe it is vulnerable to the risk of a near term severe impact as a result of any concentrations of its activities.

(b)

Principles of Consolidation

The accompanying financial statements include the consolidated accounts of CFC, RTFC and NCSC and certain entities controlled by CFC and created to hold foreclosed assets, after elimination of all material intercompany accounts and transactions. Financial Accounting Standards Board ("FASB") Interpretation No. ("FIN") 46(R), Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51, requires CFC to consolidate the financial results of RTFC and NCSC. CFC is the primary beneficiary of variable interests in RTFC and NCSC due to its exposure to absorbing the majority of expected losses.

CFC is the sole lender to and manages the lending and financial affairs of RTFC through a long-term management agreement. Under a guarantee agreement, RTFC pays CFC a fee in exchange for which CFC reimburses RTFC for loan losses. Six members of the CFC board serve as a lender advisory council to the RTFC board. All loans that require RTFC board approval also require the approval of the CFC lender advisory council. CFC is not a member of RTFC and does not elect directors to the RTFC board. RTFC is an associate member of CFC.

CFC is the primary source of funding to and manages the lending and financial affairs of NCSC through a management agreement which is automatically renewable on an annual basis unless terminated by either party. NCSC funds its programs either through loans from CFC or commercial paper and long-term notes issued by NCSC and guaranteed by CFC. In connection with these guarantees, NCSC must pay a guarantee fee and purchase from CFC interest-bearing subordinated term certificates in proportion to the related guarantee. Under a guarantee agreement, NCSC pays CFC a fee in exchange for which CFC reimburses NCSC for loan losses, excluding losses in the consumer loan program. Effective January 1, 2007, all loans that require NCSC board approval also require CFC approval. CFC does not control the election of directors to the NCSC board. NCSC is a service organization member of CFC.

RTFC and NCSC creditors have no recourse against CFC in the event of default by RTFC and NCSC, unless there is a guarantee agreement under which CFC has guaranteed NCSC and RTFC debt obligations to a third party. At November 30, 2006, CFC had guaranteed \$215 million of NCSC debt with third parties. These guarantees are not included in Note 11 at November 30, 2006 as the debt that CFC had guaranteed is reported as debt of the Company. At November 30, 2006, CFC had no guarantees of RTFC debt to third party creditors. All CFC loans to RTFC and NCSC are secured by all assets and revenues of RTFC and NCSC. At November 30, 2006, RTFC had total assets of \$2,232 million including loans outstanding to members of \$2,017 million and NCSC had total assets of \$435 million including loans outstanding of \$402 million. At November 30, 2006 and May 31, 2006, CFC had committed to lend RTFC up to \$10 billion, of which \$2,004 million was outstanding at November 30, 2006. Effective December 1, 2006, CFC's commitment to RTFC was reduced to \$4 billion. As of November 30, 2006 and May 31, 2006, CFC had committed to provide credit to NCSC of up to \$1 billion. At November 30, 2006, CFC had provided a total of \$422 million of credit to NCSC, representing \$207 million of outstanding loans and \$215 million of credit enhancements.

CFC established limited liability corporations and partnerships to hold foreclosed assets. CFC has full ownership and control of all such companies and thus consolidates their financial results. CFC presents these companies in one line on the consolidated balance sheets and the consolidated statements of operations.

Unless stated otherwise, references to the Company relate to the consolidation of CFC, RTFC, NCSC and certain entities controlled by CFC and created to hold foreclosed assets.

(c) Allowance for Loan Losses

The Company maintains an allowance for loan losses at a level estimated by management to adequately provide for probable losses inherent in the loan portfolio, which are estimated based upon a review of the loan portfolio, past loss experience, specific problem loans, economic conditions and other pertinent factors which, in management's judgment, deserve current recognition in estimating loan losses. On a quarterly basis, the Company prepares an

analysis of the adequacy of the loan loss allowance and makes adjustments to the allowance as necessary. The allowance is based on estimates and, accordingly, actual loan losses may differ from the allowance amount.

Management makes recommendations of loans to be written off to the board of directors of CFC. 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.

Activity in the loan loss allowance account is summarized below:

(in thousands)	For the six months ended November 30,		May 31,
	2006	2005	2006
Balance at beginning of period	\$611,443	\$ 589,749	\$ 589,749
Provision for loan losses	-	3,886	23,240
Write-offs	(304)	(442)	(2,197)
Recoveries	219	339	651
Balance at end of period	\$611,358	\$ 593,532	\$ 611,443

(d) Interest Income

Interest income includes the following:

(in thousands)	For the three months ended November 30,		For the six months ended November 30,	
	2006	2005	2006	2005
Interest on long-term fixed rate loans (1)	\$206,055	\$ 184,942	\$411,627	\$361,105
Interest on long-term variable rate loans (1)	30,546	37,813	62,171	88,417
Interest on short-term loans (1)	17,876	12,726	35,930	24,916
Interest on investments (2)	1,421	2,263	3,449	4,435
Conversion fees (3)	2,442	3,556	4,954	7,239
Make-whole and prepayment fees (4)	382	277	825	3,686
Commitment and guarantee fees (5)	1,260	1,740	5,469	3,339
Other fees (6)	262	9	508	66
Total interest income	\$260,244	\$ 243,326	\$524,933	\$493,203

(1) Represents interest income on loans to members.

(2) Represents interest income on the investment of cash.

(3) Conversion fees are deferred and recognized using the interest method over the remaining term of the original loan interest rate pricing term, except for a small portion of the total fee charged to cover administrative costs related to the conversion which is recognized immediately.

(4) Make-whole and prepayment fees are charged for the early repayment of principal in full and recognized when collected.

(5) Commitment fees for RTFC loan commitments are, in most cases, refundable on a prorata basis according to the amount of the loan commitment that is advanced. Such refundable fees are deferred and then recognized on a prorata basis based on the portion of the loan that is not advanced prior to the expiration of the commitment. Commitment fees on CFC loan commitments are not refundable and are billed and recognized based on the unused portion of committed lines of credit. Guarantee fees are charged based on the amount, type and term of the guarantee. Guarantee fees are deferred and amortized using the straight-line method into interest income over the life of the guarantee.

(6) Other fees include late payment fees charged on late loan payments and recognized when collected and other fees associated with syndication of loans that are deferred and amortized using the straight-line method. Additionally, other fees include loan origination fees that are deferred and amortized over the life of the facility as an addition to interest income using the straight-line method which approximates the interest method.



Deferred income on the consolidated balance sheets is comprised primarily of deferred conversion fees totaling \$30 million and \$37 million at November 30, 2006 and May 31, 2006, respectively.

## (e) Interest Expense

Interest expense includes the following:

(in thousands)	For the three months ended November 30,		For the six months ended November 30,	
	2006	2005	2006	2005
Interest expense - commercial paper and bid notes (1)	\$ 49,198	\$ 25,001	\$ 96,254	\$ 56,745
Interest expense - medium-term notes (1)	89,976	101,856	181,295	202,886
Interest expense - collateral trust bonds (1)	49,489	69,773	100,560	140,093
Interest expense - subordinated deferrable debt (1)	8,153	11,739	16,783	23,479
Interest expense - subordinated certificates (1)	11,876	11,636	23,916	23,412
Interest expense - long-term private debt (1)	30,023	10,320	60,304	13,104
Debt issuance costs (2)	2,418	3,252	9,606	5,738
Derivative cash settlements, net (3)	-	1,104	-	2,411
Commitment and guarantee fees (4)	3,649	1,257	7,317	2,459
Other fees (5)	479	155	1,681	1,043
Total interest expense	\$245,261	\$ 236,093	\$497,716	\$471,370

- (1) Represents interest expense and the amortization of discounts on the debt security.
- (2) Includes amortization of all deferred charges related to debt issuance, 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 and debt issuance costs fully amortized as part of the early retirement of debt.
- (3) Represents the net cost related to swaps that qualify for hedge accounting treatment plus the accrual from the date of the last settlement to the current period end.
- (4) Includes various fees related to funding activities, including fees paid to banks participating in the Company's revolving credit agreements and fees paid under bond guarantee agreements with RUS as part of the Rural Economic Development Loan and Grant ("REDLG") program. Fees are recognized as incurred or amortized on a straight-line basis over the life of the respective agreement.
- (5) Represents fees associated with NCSC's consumer loan program and other fees.

The Company does not include indirect costs, if any, related to funding activities in interest expense.

(f) Comprehensive Income

Comprehensive income includes the Company's net income, as well as other comprehensive income related to derivatives. Comprehensive income is calculated as follows:

(in thousands)	For the three months ended November 30,		For the six months ended November 30,	
	2006	2005	2006	2005
Net (loss) income	\$ (52,036)	\$ 63,729	\$ (92,158)	\$ 58,412
Other comprehensive income:				
Unrealized gain (loss) on derivatives	-	126	-	(1,433)
Reclassification adjustment for realized (gain) loss on derivatives	(251)	39	(502)	259
Comprehensive (loss) income	\$ (52,287)	\$ 63,894	\$ (92,660)	\$ 57,238

(g) Reclassifications

Certain reclassifications of prior period amounts have been made to conform to the current reporting format.

(2) Loans and Commitments

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

(in thousands)	November 30, 2006		May 31, 2006	
	Loans outstanding	Unadvanced (1) commitments	Loans outstanding	Unadvanced (1) commitments
Total by loan type (2):				
Long-term fixed rate loans	\$ 14,528,419	\$ -	\$ 14,546,850	\$ -
Long-term variable rate loans	2,292,653	6,232,732	2,524,722	6,146,618
Loans guaranteed by RUS	257,752	591	261,330	591

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Short-term loans	1,078,682	6,857,230	1,028,003	6,632,704
Total loans	18,157,506	13,090,553	18,360,905	12,779,913
Less: Allowance for loan losses	(611,358)	-	(611,443)	-
Net loans	\$ 17,546,148	\$ 13,090,553	\$ 17,749,462	\$ 12,779,913
Total by segment:				
CFC:				
Distribution	\$ 12,803,371	\$ 9,083,858	\$ 12,859,076	\$ 8,905,434
Power supply	2,817,155	2,795,870	2,810,663	2,635,502
Statewide and associate	118,119	131,187	124,633	110,839
CFC Total	15,738,645	12,010,915	15,794,372	11,651,775
RTFC	2,016,915	508,447	2,162,464	550,990
NCSC	401,946	571,191	404,069	577,148
Total	\$ 18,157,506	\$ 13,090,553	\$ 18,360,905	\$ 12,779,913

(1) Unadvanced commitments include loans for which loan contracts have been approved and executed, but funds have not been advanced. Additional information may be required to assure that all conditions for advance of funds have been fully met and that there has been no material change in the member's condition as represented in the supporting documents. Since commitments may expire without being fully drawn upon and a significant amount of the commitments are for standby liquidity purposes, the total unadvanced loan commitments do not necessarily represent future cash requirements. Collateral and security requirements for advances on commitments are identical to those on initial loan approval. As the interest rate on unadvanced commitments is not set, long-term unadvanced commitments have been classified in this chart as variable rate unadvanced commitments. However, at the time of the advance, the borrower may select a fixed or a variable rate.

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

The following table summarizes non-performing and restructured loans outstanding and unadvanced commitments to those borrowers by segment and by loan program:

(in thousands)	November 30, 2006		May 31, 2006	
	Loans outstanding	Unadvanced (1) commitments	Loans outstanding	Unadvanced (1) commitments
Non-performing loans:				
RTFC:				
Long-term fixed rate loans	\$ 212,984	\$ -	\$ 212,984	\$ -
Long-term variable rate loans	273,819	-	314,987	-
Short-term loans	52,272	284	49,817	296
Total RTFC loans	539,075	284	577,788	296
NCSC:				
Long-term fixed rate loans	42	-	81	-
Total non-performing loans	\$ 539,117	\$ 284	\$ 577,869	\$ 296
Restructured loans:				
CFC:				
Long-term fixed rate loans	\$ 52,420	\$ -	\$ 51,670	\$ -
Long-term variable rate loans	556,919	215,500	571,640	215,242
Short-term loans	-	-	258	-
Total CFC loans	609,339	215,500	623,568	215,242
RTFC:				
Long-term fixed rate loans	6,493	-	6,786	-
Total restructured loans	\$ 615,832	\$ 215,500	\$ 630,354	\$ 215,242

(1) Unadvanced commitments include loans for which loan contracts have been approved and executed, but funds have not been advanced. Additional information may be required to assure that all conditions for advance of funds have been fully met and that there has been no material change in the member's condition as represented in the supporting documents. Since commitments may expire without being fully drawn upon and a significant amount of the commitments are for standby liquidity purposes, the total unadvanced loan commitments do not necessarily represent future cash requirements. Collateral and security requirements for advances on commitments are identical to those on initial loan approval. As the interest rate on unadvanced commitments is not set, long-term unadvanced commitments have been classified in this chart as variable rate unadvanced commitments. However, at the time of the advance, the borrower may select a fixed or a variable rate.

Loan origination costs are deferred and amortized using the straight-line method, which approximates the interest method, over the life of the loan as a reduction to interest income. At November 30, 2006 and May 31, 2006, the balance for deferred loan origination costs related to loans outstanding totaled \$3 million.

#### Loan Security

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

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

(Dollar amounts in thousands)	November 30, 2006				May 31, 2006			
	Secured	%	Unsecured	%	Secured	%	Unsecured	%
Total by loan program:								
Long-term fixed rate loans	\$ 13,981,269	96%	\$ 547,150	4%	\$ 13,984,404	96%	\$ 562,446	4%
Long-term variable rate loans	2,168,913	95%	123,740	5%	2,414,737	96%	109,985	4%
Loans guaranteed by RUS	257,752	100%	-	-	261,330	100%	-	-
Short-term loans	184,836	17%	893,846	83%	146,835	14%	881,168	86%
Total loans	\$ 16,592,770	91%	\$ 1,564,736	9%	\$ 16,807,306	92%	\$ 1,553,599	8%
Total by segment:								
CFC	\$ 14,509,957	92%	\$ 1,228,688	8%	\$ 14,575,691	92%	\$1,218,681	8%
RTFC	1,764,716	87%	252,199	13%	1,921,635	89%	240,829	11%
NCSC	318,097	79%	83,849	21%	309,980	77%	94,089	23%
Total loans	\$ 16,592,770	91%	\$ 1,564,736	9%	\$ 16,807,306	92%	\$1,553,599	8%

### Pledging of Loans

As of November 30, 2006 and May 31, 2006, distribution system mortgage notes related to outstanding long-term loans totaling \$5,393 million and \$5,472 million, respectively, and RUS guaranteed loans qualifying as permitted investments totaling \$221 million and \$223 million, respectively, were pledged as collateral to secure CFC's collateral trust bonds under the 1994 indenture. In addition, \$2 million of cash was pledged under the 1972 indenture at November 30, 2006 and May 31, 2006.

As of November 30, 2006 and May 31, 2006, distribution system mortgage notes related to outstanding long-term loans totaling \$560 million and \$574 million, respectively were pledged as collateral to secure CFC's notes to Federal Agricultural Mortgage Corporation ("Farmer Mac").

In addition to the loans pledged as collateral at November 30, 2006 and May 31, 2006, CFC had \$2,254 million and \$2,302 million, respectively, of mortgage notes on deposit with the trustee for the \$2 billion of notes payable to the Federal Financing Bank ("FFB") of the United States Treasury (see Note 5).

The \$2 billion of notes payable to the FFB contain a rating trigger related to the Company's senior secured credit ratings from Standard & Poor's Corporation, Moody's Investors Service and Fitch Ratings. A rating trigger event exists if the Company's 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 the Company's senior secured credit ratings fall below the levels listed above, the total \$2,254 million of mortgage notes would be pledged as collateral rather than held on deposit.

A total of \$1 billion of the same notes payable to the FFB has a second rating trigger related to the appointment of a financial expert to the Company's board of directors. A rating trigger event will exist if CFC does not have a financial expert (as defined by Section 407 of the Sarbanes-Oxley Act of 2002) appointed to serve on the audit committee of its board of directors by thirty days after the CFC March 2007 annual meeting through the tenor of the bonds or if the financial expert position remains vacant for more than 90 consecutive days after the initial appointment. In November 2006, the CFC Board elected an at-large director that qualifies as a financial expert who will serve on the audit committee. The director will take his seat on the board following the CFC annual meeting in March 2007. If the Company does not satisfy the financial expert rating trigger, \$1,148 million of mortgage notes would be pledged as collateral rather than held on deposit.

### (3) Foreclosed Assets

Net assets received in satisfaction of loan receivables are recorded at the lower of cost or market and classified on the consolidated balance sheets as foreclosed assets. At November 30, 2006 and May 31, 2006, the balance of foreclosed assets included real estate developer notes receivable and limited partnership interests in certain real estate developments.

The activity for foreclosed assets is summarized below:

(in thousands)	Six months ended November 30,		Year ended
	2006	2005	May 31, 2006
Beginning balance	\$ 120,889	\$ 140,950	\$ 140,950
Results of operations	5,991	8,570	15,492
Net cash provided by	(56,831)	(1,348)	(6,401)
Sale of foreclosed assets	(487)	(28,782)	(29,152)
Ending balance of foreclosed assets	\$ 69,562	\$ 119,390	\$ 120,889

Net cash provided by foreclosed assets increased significantly during the six months ended November 30, 2006 due to full and partial paydowns of notes primarily by two limited partnership interests in certain real estate developments. At May 31, 2005, the balance of foreclosed assets also included partnership interests in real estate properties. CFC operated the real estate properties before selling such properties in August 2005 for \$30 million. A gain of \$4 million was included in the results of operations of foreclosed assets during the six months ended November 30, 2005.

## (4) Short-Term Debt and Credit Arrangements

The following is a summary of short-term debt at November 30, 2006 and May 31, 2006:

(in thousands)	November 30, 2006	May 31, 2006
Short-term debt:		
Commercial paper sold through dealers, net of discounts	\$ 1,624,813	\$ 1,658,222
Commercial paper sold directly to members, at par	1,378,519	1,184,030
Commercial paper sold directly to non-members, at par	142,775	146,294
Total commercial paper	3,146,107	2,988,546
Daily liquidity fund	245,235	266,664
Bank bid notes	100,000	100,000
Subtotal short-term debt	3,491,342	3,355,210
Long-term debt maturing within one year:		
Medium-term notes sold through dealers (1)	1,062,579	1,278,142
Medium-term notes sold through members	194,815	199,626
Foreign currency valuation account (1)	228,700	244,955
Secured collateral trust bonds	199,783	99,991
Subordinated deferrable debt (2)	-	150,000
Unsecured notes payable	15,915	15,900
Total long-term debt maturing within one year	1,701,792	1,988,614
Total short-term debt	\$ 5,193,134	\$ 5,343,824

(1) At November 30, 2006 and May 31, 2006, medium-term notes includes \$434 million of medium-term notes denominated in Euros and \$0 and \$282 million, respectively of medium-term notes denominated in Australian dollars. The foreign currency valuation account represents the change in the dollar value of foreign denominated debt due to changes in currency exchange rates from the date the debt was issued to the reporting date as required under Statement of Financial Accounting Standard ("SFAS") 52, Foreign Currency Translation.

(2) Redeemed in June 2006.

CFC issues commercial paper for periods of one to 270 days. CFC also enters into short-term bank bid note agreements, which are unsecured obligations of CFC and do not require backup bank lines for liquidity purposes. Bank bid note facilities are uncommitted lines of credit for which CFC does not pay a fee. The commitments are generally subject to termination at the discretion of the individual banks.

#### Foreign Denominated Short-Term Debt

Included in short-term debt at November 30, 2006 and May 31, 2006 are medium-term notes due within one year that are denominated in a foreign currency. At the time of issuance of short-term debt denominated in a foreign currency, CFC enters into a cross currency or cross currency interest rate exchange agreement to fix the exchange rate on all principal and interest payments through maturity. The foreign denominated short-term debt is revalued at each reporting date based on the current exchange rate. To the extent that the current exchange rate is different than the exchange rate at the time of issuance, there will be a change in the reported value of the foreign denominated short-term debt. The adjustment to the reported value of the short-term debt on the consolidated balance sheets is also reported on the consolidated statements of operations as foreign currency adjustments. As a result of entering cross



currency and cross currency interest rate exchange agreements, the adjusted short-term debt value at the reporting date does not represent the amount that CFC will ultimately pay to retire the short-term debt, unless the counterparty to the exchange agreement does not perform as required under the agreement.

#### Revolving Credit Agreements

The following is a summary of the Company's revolving credit agreements:

(Dollar amounts in thousands)	November 30, 2006	May 31, 2006	Termination Date	Facility fee per annum (1)
364-day agreement (2)	\$ 1,025,000	\$ 1,025,000	March 21, 2007	0.05 of 1%
Five-year agreement	1,025,000	1,025,000	March 22, 2011	0.06 of 1%
Five-year agreement	1,975,000	1,975,000	March 23, 2010	0.09 of 1%
	000			
Total	\$ 4,025,000	\$ 4,025,000		

(1) Facility fee determined by CFC's senior unsecured credit ratings based on the pricing schedules put in place at the initiation of the related agreement.

(2) Any amount outstanding under these agreements may be converted to a one-year term loan at the end of the revolving credit periods. If converted to a term loan, the fee on the outstanding principal amount of the term loan is 0.10 of 1% per annum.

Up-front fees of between 0.05 and 0.13 of 1% were paid to the banks based on their commitment level to the five-year agreements in place at November 30, 2006, totaling in aggregate \$3 million, which will be amortized on a straight-line basis over the life of the agreements. No up-front fees were paid to the banks for their commitment to the 364-day facility. Each

agreement contains a provision under which if borrowings exceed 50% of total commitments, a utilization fee must be paid on the outstanding balance. The utilization fees are 0.05 of 1% for the five-year agreement terminating on March 22, 2011 and the 364-day agreement terminating on March 21, 2007 and 0.10 of 1% for the five-year agreement terminating on March 23, 2010.

Effective November 30, 2006 and May 31, 2006, the Company was in compliance with all covenants and conditions under its revolving credit agreements in place at that time and there were no borrowings outstanding under such agreements.

For the purpose of calculating the required financial covenants contained in its revolving credit agreements, the Company adjusts net income, senior debt and total equity to exclude the non-cash adjustments related to SFAS 133, Accounting for Derivative Instruments and Hedging Activities, as amended and SFAS 52. The adjusted times interest earned ratio ("TIER"), as defined by the agreements, represents the interest expense adjusted to include the derivative cash settlements, plus minority interest net income, plus net income prior to the cumulative effect of change in accounting principle and dividing that total by the interest expense adjusted to include the derivative cash settlements. In addition to the non-cash adjustments related to SFAS 133 and 52, senior debt also excludes RUS guaranteed loans, subordinated deferrable debt, members' subordinated certificates and minority interest. Total equity is adjusted to include subordinated deferrable debt, members' subordinated certificates and minority interest. Senior debt includes guarantees; however, it excludes:

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

The following represents the Company's required and actual financial ratios under the revolving credit agreements at or for the six months ended November 30, 2006 and the year ended May 31, 2006:

	Requirement	November 30, 2006	May 31, 2006
Minimum average adjusted TIER over the six most recent fiscal quarters	1.025	1.10	1.11
Minimum adjusted TIER at fiscal year end (1)	1.05	1.11	1.11
Maximum ratio of senior debt to total equity	10.00	6.75	6.26

(1) The Company must meet this requirement in order to retire patronage capital.

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

#### (5) Long-Term Debt

The following is a summary of long-term debt at November 30, 2006 and May 31, 2006:

(in thousands)	November 30, 2006	May 31, 2006
Unsecured long-term debt:		
Medium-term notes, sold through dealers	\$ 4,135,195	\$ 4,174,200
Medium-term notes, sold directly to members	53,718	55,052
Subtotal	4,188,913	4,229,252
Unamortized discount	(8,319)	(9,203)
Total unsecured medium-term notes	4,180,594	4,220,049
Unsecured notes payable	2,067,855	2,074,565
Total unsecured long-term debt	6,248,449	6,294,614
Secured debt:		
Collateral trust bonds	3,651,981	3,851,981
Unamortized discount	(3,690)	(4,567)
Total secured collateral trust bonds	3,648,291	3,847,414
Secured notes payable	500,000	500,000
Total secured long-term debt	4,148,291	4,347,414
Total long-term debt	\$ 10,396,740	\$ 10,642,028

Collateral trust bonds are secured by the pledge of mortgage notes or eligible securities in an amount at least equal to the principal balance of the bonds outstanding. See Note 2 for additional information on the collateral pledged to secure the

Company's collateral trust bonds. Medium-term notes are unsecured obligations of CFC.

#### Unsecured Notes Payable

At November 30, 2006 and May 31, 2006, CFC had a total of \$2 billion under a bond purchase agreement with the FFB and a bond guarantee agreement with RUS as part of the funding mechanism for the REDLG program. As part of the REDLG program, CFC is eligible to borrow up to the amount of the outstanding loans that it has issued concurrent with RUS loans. At November 30, 2006, CFC had a total of \$2.5 billion outstanding on loans issued concurrently with RUS. As part of the REDLG program, CFC will pay to RUS a fee of 30 basis points per annum on the total amount borrowed. The \$2 billion of unsecured notes payable issued as part of the REDLG program require CFC to place on deposit mortgage notes in an amount at least equal to the principal balance of the notes outstanding. See Note 2 for additional information on the mortgage notes held on deposit.

#### Secured Notes Payable

At November 30, 2006 and May 31, 2006, the Company had outstanding a total of \$500 million of 4.656% notes to Farmer Mac due in 2008. The \$500 million of notes payable sold to Farmer Mac are secured by the pledge of mortgage notes in an amount at least equal to the principal balance of the notes outstanding. See Note 2 for additional information on the collateral pledged to secure the Company's notes payable.

#### (6) Subordinated Deferrable Debt

The following table is a summary of subordinated deferrable debt outstanding:

(Dollar amounts in thousands)	November 30, 2006	May 31, 2006
6.75% due 2043	\$ 125,000	\$ 125,000
6.10% due 2044	88,201	88,201
5.95% due 2045	98,239	98,239
7.40% due 2050	175,000	175,000
Total	\$ 486,440	\$ 486,440

#### (7) Derivative Financial Instruments

The Company is neither a dealer nor a trader in derivative financial instruments. The Company uses interest rate, cross currency and cross currency interest rate exchange agreements to manage its interest rate risk and foreign currency exchange risk.

#### Interest Rate Exchange Agreements

Consistent with SFAS 133, as amended, the Company records derivative instruments on the consolidated balance sheet as either an asset or liability measured at fair value. Changes in the fair value of derivative instruments are recognized in the derivative forward value line item of the consolidated statement of operations unless specific hedge accounting criteria are met. The change to the fair value is either recorded to other comprehensive income or interest expense, depending on whether the interest rate exchange agreement qualifies as an effective hedge. Net settlements paid and received for derivative instruments that qualify for hedge accounting are recorded in interest expense. Net settlements related to derivative instruments that do not qualify for hedge accounting are recorded as derivative cash settlements in the consolidated statement of operations. The Company formally documents, designates, and assesses the effectiveness of transactions that receive hedge accounting.

Generally, the Company's interest rate exchange agreements do not qualify for hedge accounting under SFAS 133. At November 30, 2006 and May 31, 2006, the Company did not have any interest rate exchange agreements that were accounted for using hedge accounting. At November 30, 2005, interest rate exchange agreements with a total notional

amount of \$200 million were designated as and qualified as effective cash flow hedges and were accounted for using hedge accounting. Those interest rate exchange agreements matured in February 2006.

The Company was a party to the following interest rate exchange agreements:

(in thousands)	Notional Amounts Outstanding	
	November 30, 2006	May 31, 2006
Pay fixed and receive variable	\$ 7,378,002	\$ 7,349,584
Pay variable and receive fixed	5,186,440	5,186,440
Total interest rate exchange agreements	\$ 12,564,442	\$ 12,536,024

The Company has classified cash activity associated with derivatives as an operating activity in the consolidated statements of cash flows.

Interest rate exchange agreements had the following impact on the Company:

(in thousands)	For the six months ended November 30,	
	2006	2005
Statement of Operations Impact		
Agreements that qualify for hedge accounting:		
Interest expense	\$ -	\$ (4,067)
Agreements that do not qualify for hedge accounting:		
Derivative cash settlements	26,002	32,241
Derivative forward value	(126,548)	(4,879)
Total (loss) gain on interest rate exchange agreements	\$ (100,546)	\$ 23,295
Comprehensive Income Impact		
Agreements that qualify for hedge accounting:		
Unrealized loss on derivatives	\$ -	\$ (1,386)
Amortization of transition adjustment	(502)	259
Total comprehensive loss	\$ (502)	\$ (1,127)

Cash settlements includes periodic amounts that were paid and received related to its interest rate exchange agreements. During the six months ended November 30, 2005, cash settlements also includes \$1 million of fees received from counterparties for the Company's termination of interest rate exchange agreements. These agreements were terminated due to the prepayment of RTFC loans during the six months ended November 30, 2005, the proceeds of which were used to pay down the underlying debt for the terminated interest rate exchange agreements.

For the six months ended November 30, 2006 and 2005, the derivative forward value also includes amortization to income of \$0.4 million and to expense of \$0.3 million, respectively, related to the transition adjustment recorded as an other comprehensive loss on June 1, 2001, the date the Company implemented SFAS 133. The transition adjustment will be amortized into earnings over the remaining life of the related interest rate exchange agreements. Approximately \$0.8 million is expected to be amortized to income over the next twelve months related to the transition adjustment and will continue through April 2029.

#### Cross Currency and Cross Currency Interest Rate Exchange Agreements

The Company entered into the cross currency and cross currency interest rate exchange agreements related to the issuance of medium-term notes denominated in Euros and Australian dollars. In addition to foreign currency exchange, the agreements that do not qualify for hedge accounting also synthetically change the interest rate from a fixed rate on the foreign denominated debt to variable rate U.S. denominated debt or from a variable rate on the

foreign denominated debt to a different variable rate.

Generally, the Company's cross currency and cross currency interest rate exchange agreements do not qualify for hedge accounting under SFAS 133. At November 30, 2005, cross currency exchange agreements with a total notional amount of \$390 million were designated as and qualified as effective cash flow hedges and were accounted for using hedge accounting. Those cross currency exchange agreements matured in February 2006.

At November 30, 2006 and May 31, 2006, the Company was a party to the following cross currency and cross currency interest rate exchange agreements, none of which were accounted for using hedge accounting:

Maturity Date	Original Exchange Rate	Notional Principal Amount			
		U.S. Dollars (5)		Foreign Currency	
		November 30, 2006	May 31, 2006	November 30, 2006	May 31, 2006
July 7, 2006	1.506	\$ -	\$ 166,000(3)	- AUD (2)	250,000 AUD (2)
July 7, 2006	1.506	-	116,200(4)	- AUD (2)	175,000 AUD (2)
March 14, 2007	1.153	433,500(4)	433,500(4)	500,000 EU (1)	500,000 EU (1)
Total		\$ 433,500	\$ 715,700	500,000	925,000

(1) EU - Euros

(2) AUD - Australian dollars

(3) These agreements also change the interest rate from a foreign denominated variable rate to a U.S. dollar denominated variable rate.

(4) These agreements also change the interest rate from a foreign denominated fixed rate to a U.S. dollar denominated variable rate.

(5) Amounts in the chart represent the U.S. dollar value at the initiation of the exchange agreement. At November 30, 2006 and May 31, 2006, one U. S. dollar was the equivalent of 0.755 and 0.780 Euros, respectively. One U.S. dollar was the equivalent of 1.329 Australian dollars at May 31, 2006.

Cross currency and cross currency interest rate exchange agreements had the following impact on the Company:

(in thousands)	For the six months ended November 30,	
	2006	2005
<b>Statement of Operations Impact</b>		
Agreements that qualify for hedge accounting:		
Interest expense	\$ -	\$ 1,656
Agreements that do not qualify for hedge accounting:		
Derivative cash settlements	(1,133)	4,775
Derivative forward value	17,014	(45,726)
Total gain (loss) on interest rate exchange agreements	\$ 15,881	\$ (39,295)
<b>Comprehensive Income Impact</b>		
Agreements that qualify for hedge accounting:		
Unrealized loss on derivatives	\$ -	\$ (47)

#### Rating Triggers

The Company has certain interest rate, cross currency and cross currency interest rate exchange agreements that contain a provision called a rating trigger. Under a rating trigger, 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 of the underlying derivative instrument. Rating triggers are not separate financial instruments and are not separate derivatives under SFAS 133. The rating triggers contained in certain of the Company's derivative contracts are based on its senior unsecured credit rating from Standard & Poor's Corporation and Moody's Investors Service.

At November 30, 2006, the Company has the following notional amount and fair values associated with exchange agreements that contain rating triggers. For the purpose of the presentation, the Company has grouped the rating triggers into two categories, (1) ratings from Moody's Investors Service falls to Baa1 or from Standard & Poor's Corporation falls to BBB+ and (2) ratings from Moody's Investors Service falls below Baa1 or from Standard & Poor's Corporation falls below BBB+.

(in thousands)		Required Company Payment	Amount Company Would Collect	Net Total
Rating Level:	Notional Amount			
Fall to Baa1/BBB+	\$ 1,122,773 \$	(6,105) \$	33,275 \$	27,170
Fall below Baa1/BBB+	8,776,916	(66,014)	254,027	188,013
Total	\$ 9,899,689 \$	(72,119) \$	287,302 \$	215,183

(8) Members' Subordinated Certificates

CFC's members are required to purchase membership certificates as a condition of membership. Such certificates are interest-bearing unsecured, subordinated debt of CFC. Members may purchase the certificates over time as a percentage of the amount they borrow from CFC. RTFC and NCSC members are not required to purchase membership certificates as a condition of membership. CFC membership certificates typically have an original maturity of 100 years and pay interest at 5%. The weighted average maturity for all membership subordinated certificates outstanding at November 30, 2006 and May 31, 2006 was 70 years.

Members obtaining long-term loans, certain short-term loans or guarantees are generally required to purchase additional loan or guarantee subordinated certificates with each such loan or guarantee based on the members' CFC debt to equity ratio. These certificates are unsecured, subordinated debt of the Company.

Certificates currently purchased in conjunction with long-term loans are generally non-interest bearing. CFC's policy regarding the purchase of loan subordinated certificates requires members with a CFC debt to equity ratio in excess of the limit in the policy to purchase a non-amortizing/non-interest bearing subordinated certificate in the amount of 2% for distribution systems and 7% for power supply systems. CFC associates and RTFC members are required to purchase loan subordinated certificates of 10% of each long-term loan advance. For non-standard credit facilities, the borrower is required to purchase interest bearing certificates in amounts determined appropriate by CFC based on the circumstances of the transaction.

The maturity dates and the interest rates payable on guarantee subordinated certificates purchased in conjunction with CFC's guarantee program vary in accordance with applicable CFC policy. Members may be required to purchase non-interest-bearing debt service reserve subordinated certificates in connection with CFC's guarantee of long-term tax-exempt bonds (see Note 11). CFC pledges proceeds from the sale of such certificates to the debt service reserve fund established in connection with the bond issue and any earnings from the investments of the fund inure solely to the benefit of the members for whom the bonds are issued. These certificates have varying maturities not exceeding the longest maturity of the guaranteed obligation.

#### (9) Minority Interest

At November 30, 2006 and May 31, 2006, the Company reported minority interests of \$21 million and \$22 million, respectively, on the consolidated balance sheets. Minority interest represents the 100% interest that RTFC and NCSC members have in their respective organizations.

During the six months ended November 30, 2006, the balance of minority interest decreased by \$1 million of minority interest net loss for the six months ended November 30, 2006.

#### (10) Equity

CFC is required by the District of Columbia cooperative law to have a methodology to allocate its net earnings to its members. CFC maintains the current year net earnings as unallocated through the end of its fiscal year. At that time, CFC's board of directors allocates its net earnings to members in the form of patronage capital and to board approved reserves. Currently, CFC has two such board approved reserves, the education fund and the members' capital reserve. CFC allocates a small portion, less than 1%, of net earnings annually to the education fund. The allocation to the education fund must be at least 0.25% of net earnings as required by CFC's bylaws. Funds from the education fund are disbursed annually to fund cooperative education among employees and directors of cooperatives in the service territories of each state. The board of directors determines the amount of net earnings that is allocated to the members' capital reserve, if any. The members' capital reserve represents earnings that are held by CFC to increase equity retention. The net earnings held in the members' capital reserve have not been allocated to any member, 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. CFC bases the amount of net earnings allocated to each member on the members' patronage of the CFC lending programs in the year that the net earnings were earned. There is no impact 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 annually voted to retire a portion of the patronage capital allocated to members in prior years. CFC's total equity is reduced by the amount of patronage capital retired to members and by amounts disbursed from board approved reserves. CFC adjusts the net earnings it allocates to members and board

approved reserves to exclude the non-cash impacts of SFAS 133 and 52.

In July 2006, CFC's board of directors authorized the allocation of the fiscal year 2006 adjusted net earnings as follows: \$0.8 million to the education fund and \$95 million to members in the form of patronage capital. The board of directors also authorized the allocation of \$7 million from the members' capital reserve. In July 2006, CFC's board of directors authorized the retirement of allocated net earnings totaling \$84 million, representing 70% of the fiscal year 2006 allocation and one-ninth of the fiscal years 1991, 1992 and 1993 allocated net earnings. This amount was returned to members in cash in August 2006. Future allocations and retirements of net earnings will be made annually as determined by CFC's board of directors with due regard for CFC's financial condition. The board of directors for CFC has the authority to change the policy for allocating and retiring net earnings at any time, subject to applicable cooperative law.

At November 30, 2006 and May 31, 2006, equity included the following components:

(in thousands)	November 30, 2006	May 31, 2006
Membership fees	\$ 993	\$ 994
Education fund	801	1,281
Members' capital reserve	156,844	156,844
Allocated net income	301,985	386,232
Unallocated net income	31,474	-
Total members' equity	492,097	545,351
Prior years cumulative derivative forward value and foreign currency adjustments	229,417	229,049
Current period derivative forward value (1)	(106,333)	22,962
Current period foreign currency adjustments	(17,299)	(22,594)
Total retained equity	597,882	774,768
Accumulated other comprehensive income	12,706	13,208
Total equity	\$ 610,588	\$ 787,976

(1) Represents the derivative forward value (loss) gain recorded by CFC for the period.

#### (11) Guarantees

The Company guarantees certain contractual obligations of its members so that they may obtain various forms of financing. With the exception of letters of credit, the underlying obligations may not be accelerated so long as the Company performs under its guarantee. At November 30, 2006 and May 31, 2006, the Company had recorded a guarantee liability totaling \$19 million and \$17 million, respectively, which represents the contingent and non-contingent exposure related to guarantees of members' debt obligations. The contingent guarantee liability at November 30, 2006 and May 31, 2006 totaled \$15 million based on management's estimate of exposure to losses within the guarantee portfolio. The Company uses factors such as internal risk rating, remaining term of guarantee, corporate bond default probabilities and estimated recovery rates in estimating its contingent exposure. The remaining balance of the total guarantee liability of \$4 million and \$2 million at November 30, 2006 and May 31, 2006, respectively, relates to the Company's non-contingent obligation to stand ready to perform over the term of its guarantees that it has entered into or modified since January 1, 2003 in accordance with FIN No. 45, Guarantor's Accounting and Disclosure Requirement for Guarantees, Including Indirect Guarantees of Indebtedness of Others (an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No. 34). The non-contingent obligation is estimated based on guarantee fees received. The fees are deferred and amortized on the straight-line method into interest income over the term of the guarantees. The Company deferred fees of \$3 million and \$1 million for the six months ended November 30, 2006 and 2005, respectively, related to new guarantees issued during the periods. Activity in the guarantee liability account is summarized below:

(in thousands)	For the six months ended November 30, 2006	2005	Year ended May 31, 2006
Beginning balance	\$ 16,750	\$ 16,094	\$ 16,094
Net change in non-contingent liability	1,575	1,043	1,356
Provision for (recovery of) contingent guarantee liability	400	(2,600)	(700)

Ending balance	\$ 18,725	\$ 14,537	\$ 16,750
Liability as a percentage of total guarantees	1.64%	1.39%	1.55%

The following chart summarizes total guarantees by type and segment:

(in thousands)	November 30, 2006	May 31, 2006
Total by type:		
Long-term tax exempt bonds (1)	\$ 588,220	\$ 607,655
Indemnifications of tax benefit transfers (2)	116,936	123,544
Letters of credit (3)	364,484	272,450
Other guarantees (4)	73,685	75,331
Total	\$ 1,143,325	\$ 1,078,980
Total by segment:		
CFC:		
Distribution	\$ 147,389	\$ 70,166
Power supply	893,276	921,930
Statewide and associate	25,378	32,873
CFC total	1,066,043	1,024,969
RTFC	50	-
NCSC	77,232	54,011
Total	\$ 1,143,325	\$ 1,078,980

- (1) The maturities for this type of guarantee run through 2026. CFC has guaranteed debt issued in connection with the construction or acquisition of pollution control, solid waste disposal, industrial development and electric distribution facilities. CFC has unconditionally guaranteed to the holders or to trustees for the benefit of holders of these bonds the full principal, premium, if any, and interest on each bond when due. In addition, CFC has agreed to make up, at certain times, deficiencies in the debt service reserve funds for certain of these issues of bonds. In the event of default by a system for non-payment of debt service, CFC is obligated to pay any required amounts under its guarantees, which will prevent the acceleration of the bond issue. The system is required to repay, on demand, any amount advanced by CFC and interest thereon pursuant to the documents evidencing the system's reimbursement obligation.

Of the amounts shown above, \$556 million and \$572 million as of November 30, 2006 and May 31, 2006, respectively, are adjustable or floating/fixed rate bonds. The floating interest rate on such bonds may be converted to a fixed rate as specified in the indenture for each bond offering. During the variable rate period (including at the time of conversion to a fixed rate), CFC has unconditionally agreed to purchase bonds tendered or put for redemption if the remarketing agents have not previously sold such bonds to other purchasers. CFC's maximum potential exposure includes guaranteed principal and interest related to the bonds. CFC is unable to determine the maximum amount of interest that it could be required to pay related to the floating rate bonds. As of November 30, 2006, CFC's maximum potential exposure for the \$33 million of fixed rate tax-exempt bonds is \$42 million. Many of these bonds have a call provision that in the event of a default would allow CFC to trigger the call provision. This would limit CFC's exposure to future interest payments on these bonds. CFC's maximum potential exposure is secured by a mortgage lien on all of the system's assets and future revenues. However, if the debt is accelerated because of a determination that the interest thereon is not tax-exempt, the system's obligation to reimburse CFC for any guarantee payments will be treated as a long-term loan.

- (2) The maturities for this type of guarantee run through 2015. CFC has unconditionally guaranteed to lessors certain indemnity payments, which may be required to be made by the lessees in connection with tax benefit transfers. In the event of default by a system for non-payment of indemnity payments, CFC is obligated to pay any required amounts under its guarantees, which will prevent the acceleration of the indemnity

payments. The member is required to repay any amount advanced by CFC and interest thereon pursuant to the documents evidencing the system's reimbursement obligation. The amounts shown represent CFC's maximum potential exposure for guaranteed indemnity payments. A member's obligation to reimburse CFC for any guarantee payments would be treated as a long-term loan to the extent of any cash received by the member at the outset of the transaction. This amount is secured by a mortgage lien on all of the system's assets and future revenues. 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 further guarantees of this nature are anticipated.

- (3) The maturities for this type of guarantee run through 2017. Additionally, letters of credit totaling \$7 million at November 30, 2006 have a term of one year and automatically extend for a period of one year unless the Company cancels the agreement within 120 days of maturity (in which case, the beneficiary may draw on the letter of credit). The Company issues irrevocable letters of credit to support members' obligations to energy marketers and other third parties and to the Rural Business and Cooperative Development Service with issuance fees as may be determined from time to time. Each letter of credit issued is supported by a reimbursement agreement with the member on whose behalf the letter of credit was issued. In the event a beneficiary draws on a letter of credit, the agreement generally requires the member to reimburse the Company within one year from the date of the draw. Interest would accrue from the date of the draw at the line of credit variable rate of interest in effect on such date. The agreement also requires the member to pay, as applicable, a late payment charge and all costs of collection, including reasonable attorneys' fees. As of November 30, 2006, the Company's maximum potential exposure is \$364 million, of which \$232 million is secured. Additionally, in the event of default for \$47 million of secured NCSC letters of credit, NCSC is only liable for 40% of the amount guaranteed due to a reimbursement obligation agreement for the remaining 60%. Security provisions include a mortgage lien on all of the system's assets, future revenues, and the system's commercial paper invested at the Company. In addition to the letters of credit listed in the table, under master letter of credit facilities, the Company may be required to issue up to an additional \$393 million in letters of credit to third parties for the benefit of its members at November 30, 2006. At May 31, 2006, this amount was \$217 million.
- (4) The maturities for this type of guarantee run through 2025. CFC provides other guarantees for its members. In the event of default by a system for non-payment of the obligation, CFC must pay any required amounts under its guarantees, which will prevent the acceleration of the obligation. Such guarantees may be made on a secured or unsecured basis with guarantee fees set to cover CFC's general and administrative expenses, a provision for losses and a reasonable margin. The member is required to repay any amount advanced by CFC and interest thereon pursuant to the documents evidencing the system's reimbursement obligation. Of CFC's maximum potential exposure for guaranteed principal and interest totaling \$74 million at November 30, 2006, \$3 million is secured by a mortgage lien on all of the system's assets and future revenues and the remaining \$71 million is unsecured.

CFC uses the same credit policies and monitoring procedures in providing guarantees as it does for loans and commitments.

At November 30, 2006 and May 31, 2006, CFC had a total of \$203 million and \$144 million of guarantees, representing 18% and 13% of total guarantees, respectively, under which its right of recovery from its members was not secured.

## (12) Contingencies

The Company had the following loans classified as non-performing and restructured at:

(in thousands)	November 30,		November 30,
	2006	May 31, 2006	2005
Non-performing loans	\$ 539,117	\$ 577,869	\$ 558,105
Restructured loans	615,832	630,354	588,431
Total	\$ 1,154,949	\$ 1,208,223	\$ 1,146,536

(a) At November 30, 2006, May 31, 2006 and November 30, 2005, all loans classified as non-performing were on a non-accrual status with respect to the recognition of interest income. At November 30, 2006 and May 31, 2006, \$557 million and \$569 million, respectively, of restructured loans were on non-accrual status with respect to the recognition of interest income. At November 30, 2005, there were \$581 million of restructured loans on non-accrual status. A total of \$2 million and \$0.3 million of interest income was accrued on restructured loans during the six months ended November 30, 2006 and 2005, respectively.

Interest income was reduced as follows as a result of holding loans on non-accrual status:

(in thousands)	For the six months ended November 30,	
	2006	2005
Non-performing loans	\$ 20,903	\$ 20,929
Restructured loans	19,812	17,031
Total	\$ 40,715	\$ 37,960

(b) The Company classified \$1,148 million and \$1,201 million of loans as impaired pursuant to the provisions of SFAS 114, Accounting by Creditors for Impairment of a Loan - an Amendment of SFAS 5 and SFAS 15, as amended, at November 30, 2006 and May 31, 2006, respectively. The Company reserved \$452 million and \$447 million of the loan loss allowance for such impaired loans at November 30, 2006 and May 31, 2006, respectively. The amount included in the loan loss allowance for such loans was based on a comparison of the present value of the expected future cash flow associated with the loan discounted at the original contract interest rate and/or the estimated fair value of the collateral securing the loan to the recorded investment in the loan. Impaired loans may be on accrual or non-accrual status with respect to the recognition of interest income based on a review of the terms of the restructure agreement and borrower performance. The Company accrued a total of \$2 million of interest income on impaired loans for the six months ended November 30, 2006. The Company did not accrue interest income on loans classified as impaired during the six months ended November 30, 2005. The average recorded investment in impaired loans for the six months ended November 30, 2006 and 2005 was \$1,153 million and \$1,158 million, respectively.



The Company updates impairment calculations on a quarterly basis. Since a borrower's original contract rate may include a variable rate component, calculated impairment could vary with changes to the Company's variable rate, independent of a borrower's underlying financial performance or condition. In addition, the calculated impairment for a borrower will fluctuate based on changes to certain assumptions. Changes to assumptions include, but are not limited to the following:

- \* court rulings,
- \* changes to collateral values, and
- \* changes to expected future cash flows both as to timing and amount.

(c) At November 30, 2006 and May 31, 2006, CFC had a total of \$557 million and \$569 million, respectively, of loans outstanding to Denton County Electric Cooperative, d/b/a CoServ Electric ("CoServ"), a large electric distribution cooperative located in Denton County, Texas, that provides retail electric service to residential and business customers. All loans have been on non-accrual status since January 1, 2001. Total loans to CoServ at November 30, 2006 and May 31, 2006 represented 2.9% of the Company's total loans and guarantees outstanding.

Under the terms of a bankruptcy settlement, CFC restructured its loans to CoServ. CoServ is scheduled to make quarterly payments to CFC through December 2037. As part of the restructuring, CFC may be obligated to provide up to \$200 million of

senior secured capital expenditure loans to CoServ for electric distribution infrastructure through December 2012. If CoServ requests capital expenditure loans from CFC, these loans will be provided at the standard terms offered to all borrowers and will require debt service payments in addition to the quarterly payments that CoServ is required to make to CFC. As of November 30, 2006, no amounts have been advanced to CoServ under this loan facility. On December 19, 2006, CoServ requested a \$20 million advance under the \$200 million capital expenditure loan facility from CFC. The funds were advanced to CoServ on December 27, 2006. To date, CoServ has made all payments required under the restructure agreement. Under the terms of the restructure agreement, CoServ has the option to prepay the restructured loan for \$415 million plus an interest payment true up on or after December 13, 2007 and for \$405 million plus an interest payment true up on or after December 13, 2008.

CoServ and CFC have no claims related to any of the legal actions asserted prior to or during the bankruptcy proceedings. CFC's legal claim against CoServ is limited to CoServ's performance under the terms of the bankruptcy settlement.

Based on its analysis, the Company believes that it is adequately reserved for its exposure to CoServ at November 30, 2006.

(d) VarTec Telecom, Inc. ("VarTec") is a telecommunications company and RTFC borrower located in Dallas, Texas. RTFC is VarTec's principal senior secured creditor. At November 30, 2006 and May 31, 2006, RTFC had a total of \$50 million and \$90 million, respectively, of loans outstanding to VarTec. At November 30, 2006 and May 31, 2006, all loans to VarTec were on non-accrual status, resulting in the application of all payments received against principal.

VarTec and 16 of its U.S.-based affiliates, which were guarantors of VarTec's debt to RTFC, filed voluntary petitions under Chapter 11 of the United States Bankruptcy Code on November 1, 2004 in Dallas, Texas. On July 29, 2005, the court approved a sale of VarTec's remaining operating assets (the "Domestic Assets Sale"). Final proceeds from the closing of the Domestic Assets Sale were received in June 2006 totaling \$40 million. Pursuant to court order, all net proceeds of asset sales, including the Domestic Assets Sale, have been provisionally applied to RTFC's secured debt. The application is subject to third parties' rights, if any, superior to RTFC's rights and liens, and to further court order to require the return of such funds for use as cash collateral under the Bankruptcy Code. On June 19, 2006, the Chapter 11 proceedings were converted to Chapter 7 proceedings and a Chapter 7 trustee was appointed for each of the estates.

On June 10, 2005, the Official Committee of Unsecured Creditors (the "UCC") initiated an adversary proceeding against RTFC in the United States Bankruptcy Court for the Northern District of Texas, Dallas Division. As a result of the conversion of the proceedings to Chapter 7, the UCC has been dissolved and the Chapter 7 trustee is now the plaintiff in the adversary proceedings. The adversary proceeding asserts the following claims: (i) that RTFC may have engaged in wrongful activities prior to the filing of the bankruptcy proceeding (e.g., RTFC had "control" over VarTec's affairs, RTFC exerted "financial leverage" over VarTec and is liable for VarTec's "deepening insolvency"; the "deepening insolvency" claim was dismissed by the Court on December 6, 2005); (ii) that RTFC's claims against VarTec should be equitably subordinated to the claims of other creditors because of the alleged wrongful activities; and (iii) that certain payments made by VarTec to RTFC and certain liens granted to RTFC are avoidable as preferences or fraudulent transfers or should otherwise be avoided and re-distributed for the benefit of VarTec's bankruptcy estates. The adversary proceeding identifies payments made by VarTec to RTFC of approximately \$141 million, but does not specify damages sought. On November 14, 2006, the plaintiff supplemented its required disclosures and asserted alternative calculations of damages under its various legal theories, ranging from \$32 million to \$235 million. Trial, if necessary, on the merits of the remaining claims is currently scheduled for March 5, 2007. The trial date is subject to change.

On October 14, 2005, the Bankruptcy Court approved an administrative debtor-in-possession ("DIP") facility from RTFC in the amount of \$9 million, of which \$9 million was outstanding as of November 30, 2006. The maturity of the DIP facility was extended to June 15, 2007, but RTFC has no obligation to fund beyond those budgeted expenses which accrued prior to June 15, 2006. However, RTFC may consider providing the estate with further DIP funding to

pursue the collection of various claims.

Based on its analysis, the Company believes that it is adequately reserved for its exposure to VarTec at November 30, 2006.

(e) Innovative Communication Corporation ("ICC") is a diversified telecommunications company and RTFC borrower headquartered in St. Croix, United States Virgin Islands ("USVI"). In the USVI, through its subsidiary Virgin Islands Telephone Corporation d/b/a Innovative Telephone ("Vitelco"), ICC provides wire line local and long-distance telephone services. Cable television service and/or wireless telephone service is provided to subscribers in the USVI and a number of other islands located in the eastern and southern Caribbean and mainland France. ICC also owns a local newspaper based in St. Thomas, USVI and operates a public access television station that serves the USVI.

As of November 30, 2006 and May 31, 2006, RTFC had \$489 million and \$488 million, respectively, in loans outstanding to ICC. All loans to ICC have been on non-accrual status since February 1, 2005. ICC has not made debt service payments to the Company since June 2005.

RTFC is the primary secured lender to ICC. RTFC's collateral for the loans includes (i) a series of mortgages, security agreements, financing statements, pledges and guaranties creating liens in favor of RTFC on substantially all of the assets and voting stock of ICC, (ii) a direct pledge of 100% of the voting stock of ICC's USVI local exchange carrier subsidiary, Vitelco, (iii) secured guaranties, mortgages and direct and indirect stock pledges encumbering the assets and ownership interests in substantially all of ICC's other operating subsidiaries and certain of its parent entities, including ICC's immediate parent, Emerging Communication, Inc., a Delaware corporation ("Emcom") and Emcom's parent, Innovative Communication Company LLC, a Delaware limited liability company ("ICC-LLC"), and (iv) a personal guaranty of the loans from ICC's indirect majority shareholder and chairman, Jeffrey Prosser ("Prosser").

Beginning on June 1, 2004, RTFC filed a series of lawsuits against ICC, Prosser and others for failure to comply with the terms of ICC's loan agreement with RTFC dated August 27, 2001 as amended on April 4, 2003 (hereinafter, the "RTFC Lawsuits"). In response to the RTFC Lawsuits, ICC, Vitelco and Prosser denied liability and asserted claims, by way of counterclaim and by filing its own lawsuits against RTFC, CFC and certain of RTFC's officers, seeking various remedies, including reformation of the loan agreement, injunctive relief, and damages. The remedies were based on various theories including a claim that RTFC breached an alleged funding obligation for the settlement of litigation brought by Emcom shareholders (the "Greenlight Entities") against ICC-LLC, ICC and some of ICC's directors, and a claim that Emcom and ICC-LLC were entitled to contribution from RTFC and CFC in connection with judgments that the Greenlight Entities had been awarded (the "ICC Claims," together with the RTFC Lawsuits, the "Loan Litigation"). Venue of the Loan Litigation ultimately was fixed in the District Court for the District of the Virgin Islands.

On February 10, 2006, Greenlight filed petitions for involuntary bankruptcy against Prosser, Emcom and ICC-LLC in the United States Bankruptcy Court for the District of Delaware. RTFC has appeared in the proceedings as a party-in-interest in accordance with the provisions of the United States Bankruptcy Code. Venue of the Prosser, Emcom and ICC-LLC bankruptcy proceedings was later transferred to the United States District Court for the Virgin Islands, Bankruptcy Division, by order of the Delaware Court on December 16, 2006 following the voluntary filings described below, however, on December 24, 2006, the debtors filed a motion asking the District Court for the Virgin Islands to withdraw its standing order of reference with respect to their bankruptcy cases and to administer the cases in the District Court instead of the bankruptcy division. No hearing has been scheduled on the debtors' motion. RTFC and Greenlight have filed motions, scheduled to be heard on February 5, 2007, requesting reconsideration of the venue order in light of the debtors' request that the reference be withdrawn.

On April 26, 2006, RTFC reached a settlement of the Loan Litigation with ICC, Vitelco, ICC-LLC, Emcom, their directors and Prosser, individually. Under the settlement, RTFC obtained entry of judgments in the District Court for the District of the Virgin Islands against ICC for approximately \$525 million and Prosser for approximately \$100 million. RTFC also obtained dismissals with prejudice of all counterclaims, affirmative defenses and other lawsuits alleging wrongful acts by RTFC, certain of its officers, and CFC. Various parties also reached agreement for ICC to satisfy the RTFC judgments in the third quarter of calendar year 2006, subject to certain terms and conditions, however, on July 31, 2006, certain of the parties obligated to satisfy the RTFC judgments under the agreement filed voluntary bankruptcy proceedings, as described below, in order to obtain additional time to satisfy the judgments.

On July 31, 2006, ICC-LLC, and Emcom each filed a voluntary petition under Chapter 11 of the United States Bankruptcy Code in the United States District Court for the Virgin Islands, Division of St. Thomas and St. John, Bankruptcy Division, and Prosser, individually, filed a voluntary petition under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Virgin Islands. Prosser's case has been transferred to the United States District Court for the Virgin Islands, Division of St. Thomas and St. John, Bankruptcy Division. Each of the debtors is obligated to RTFC, for certain obligations of ICC, including court judgments. On September 25, 2006, ICC-LLC, Emcom and Prosser jointly filed a motion in the voluntary bankruptcy proceedings

seeking court authority to assume the agreement under which each is obligated to satisfy the RTFC judgments. The debtors filed the motion in order to request a ruling that they could satisfy the RTFC judgments at a discount. On November 7, 2006, the bankruptcy court denied the motion without prejudice to refiling, finding that assumption of the agreement was impossible under the debtors' then-proposed cure provisions. The debtors continue to seek a sale or refinancing of their assets in an effort to satisfy their debts to RTFC.

On November 22, 2006, ICC-LLC, Emcom and Prosser each filed motions requesting an order preserving their respective exclusive rights to file a plan of reorganization. The Court granted an extension of exclusivity through January 12, 2007.

On December 1, 2006, RTFC filed a motion to lift the automatic stay in bankruptcy in the Emcom case, seeking permission to enforce RTFC's security interest in the common stock of ICC in partial satisfaction of its judgments. An evidentiary hearing was held on January 9, 2007 and the Court deferred its ruling until completion of evidentiary hearings on other motions, scheduled for January 19, 2007.

On December 19, 2006, the United States Trustee filed a motion to appoint Chapter 11 trustees for the bankruptcy estates of ICC-LLC and Emerging, asserting that the appointment of a trustee was in the "best interest of the creditors and other interest holders." An evidentiary hearing on the motion has been scheduled for January 19, 2007.

Also on December 19, 2006, the Greenlight Entities filed a motion to convert Prosser's individual bankruptcy case from Chapter 11 reorganization to Chapter 7 liquidation, which would require appointment of a Chapter 7 trustee for the bankruptcy estate. On December 19, 2006, RTFC filed a motion to convert and joinder in support of the Greenlight Entities' motion to convert Prosser's individual case to Chapter 7. An evidentiary hearing was held on January 9, 2007 and the Court deferred its ruling until completion of evidentiary hearings on other motions, scheduled for January 19, 2007.

Based on its analysis, the Company believes that it is adequately reserved for its exposure to ICC at November 30, 2006.

(f) Pioneer Electric Cooperative, Inc. ("Pioneer") is an electric distribution cooperative located in Greenville, Alabama. Pioneer had also invested in a propane gas operation, which it recently sold. Pioneer has experienced deterioration in its financial condition as a result of losses in the gas operation. At November 30, 2006 and May 31, 2006, CFC had a total of \$52 million and \$54 million, respectively, in loans outstanding to Pioneer. Pioneer was current with respect to all debt service payments at November 30, 2006. All loans to Pioneer remain on accrual status with respect to the recognition of interest income. CFC is the principal creditor to Pioneer.

On March 9, 2006, CFC and Pioneer agreed on the terms of a debt modification that resulted in the loans being classified as restructured. Under the amended agreement, CFC extended the maturity of the outstanding loans and granted a two-year deferral of principal payments. In addition, CFC agreed to make available a line of credit for general corporate purposes. The restructured loans are secured by first liens on substantially all of the assets and revenues of Pioneer.

Based on its analysis, the Company believes that it is adequately reserved for its exposure to Pioneer at November 30, 2006.

(13) Segment Information

The Company's consolidated financial statements include the financial results of CFC, RTFC and NCSC. Full financial statements are produced for each of the three companies and are the primary reports that management reviews in evaluating performance. The segment presentation for the three and six months ended November 30, 2006 and 2005 reflect the operating results of each of the three companies as a separate segment.

As stated elsewhere in the consolidated financial statements, CFC is the sole lender to RTFC and the primary source of funding for NCSC. NCSC also obtains funding from third parties with a CFC guarantee. Thus, CFC takes all of the risk related to the funding of the loans to RTFC and NCSC, and in return, CFC earns net interest income on the loans to RTFC and NCSC.

Pursuant to guarantee agreements, CFC has agreed to indemnify RTFC and NCSC for loan losses, with the exception of the NCSC consumer loan program. Thus, CFC maintains the majority of the total consolidated loan loss allowance.

A small loan loss allowance is maintained by NCSC to cover its consumer loan exposure.

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The following chart contains consolidated statement of operations for the six months ended November 30, 2006 and consolidated balance sheet information as of November 30, 2006.

(in thousands)	CFC	RTFC	NCSC	Consolidated
<b>Statement of Operations:</b>				
Interest income	\$ 454,239	\$ 55,402	\$ 15,292	\$ 524,933
Interest expense	(432,079)	(52,054)	(13,583)	(497,716)
Net interest income	22,160	3,348	1,709	27,217
Provision for loan losses	-	-	-	-
Net interest income after provision for loan losses	22,160	3,348	1,709	27,217
<b>Non-interest income:</b>				
Rental and other income	307	-	318	625
Derivative cash settlements	24,677	-	192	24,869
Results of operations of foreclosed assets	5,991	-	-	5,991
Total non-interest income	30,975	-	510	31,485
<b>Non-interest expense:</b>				
General and administrative expenses	(21,260)	(2,540)	(1,705)	(25,505)
Provision for guarantee liability	(400)	-	-	(400)
Derivative forward value	(106,334)	-	(3,200)	(109,534)
Foreign currency adjustments	(17,299)	-	-	(17,299)
Total non-interest expense	(145,293)	(2,540)	(4,905)	(152,738)
(Loss) income prior to income taxes and minority interest	(92,158)	808	(2,686)	(94,036)
Income taxes	-	180	1,020	1,200
Net (loss) income per segment reporting	\$ (92,158)	\$ 988	\$ (1,666)	\$ (92,836)
<b>Reconciliation of net loss:</b>				
Net loss per segment reporting				\$ (92,836)
Minority interest				678
Net loss per consolidated statement of operations				\$ (92,158)
<b>Assets:</b>				
Loans to members	\$15,738,645	\$2,016,915	\$401,946	\$18,157,506
Less: Allowance for loan losses	(610,725)	-	(633)	(611,358)
Loans to members, net	15,127,920	2,016,915	401,313	17,546,148
Other assets	843,447	215,451	33,300	1,092,198



Total assets	\$15,971,367	\$2,232,366	\$434,613	\$ 18,638,346
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The following chart contains the consolidated statement of operations for the six months ended November 30, 2005 and consolidated balance sheet information at November 30, 2005.

(in thousands)	CFC	RTFC	NCSC	Consolidated
<b>Statement of Operations:</b>				
Interest income	\$ 407,850	\$ 70,187	\$ 15,166	\$ 493,203
Interest expense	(392,501)	(66,490)	(12,379)	(471,370)
Net interest income	15,349	3,697	2,787	21,833
Provision for loan losses	(3,886)	-	-	(3,886)
Net interest income after provision for loan losses	11,463	3,697	2,787	17,947
<b>Non-interest income:</b>				
Rental and other income	1,475	-	-	1,475
Derivative cash settlements	37,765	-	(749)	37,016
Results of operations of foreclosed assets	8,570	-	-	8,570
Gain on sale of building and land	37,740	-	-	37,740
Total non-interest income	85,550	-	(749)	84,801
<b>Non-interest expense:</b>				
General and administrative expenses	(21,602)	(2,220)	(1,046)	(24,868)
Recovery of guarantee liability	2,600	-	-	2,600
Derivative forward value	(54,078)	-	3,473	(50,605)
Foreign currency adjustments	34,479	-	-	34,479
Total non-interest expense	(38,601)	(2,220)	2,427	(38,394)
Income prior to income taxes and minority interest	58,412	1,477	4,465	64,354
Income taxes	-	(34)	(1,695)	(1,729)
Net income per segment reporting	\$ 58,412	\$ 1,443	\$ 2,770	\$ 62,625
<b>Reconciliation of net income:</b>				
Net income per segment reporting				\$ 62,625
Minority interest				(4,213)
Net income per consolidated statement of operations				\$ 58,412
<b>Assets:</b>				
Loans to members	\$ 15,429,894	\$ 2,269,500	\$ 447,364	\$ 18,146,758
Less: Allowance for loan losses	(592,358)	-	(1,174)	(593,532)
Loans to members, net	14,837,536	2,269,500	446,190	17,553,226
Other assets	1,058,624	241,708	42,252	1,342,584
Total assets	\$ 15,896,160	\$ 2,511,208	\$ 488,442	\$ 18,895,810

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The following chart contains the consolidated statement of operations for the three months ended November 30, 2006.

(in thousands)	CFC	RTFC	NCSC	Consolidated
Statement of Operations:				
Interest income	\$ 225,247	\$ 27,289	\$ 7,708	\$ 260,244
Interest expense	(212,884)	(25,546)	(6,831)	(245,261)
Net interest income	12,363	1,743	877	14,983
Provision for loan losses	-	-	-	-
Net interest income after provision for loan losses	12,363	1,743	877	14,983
Non-interest income:				
Rental and other income	154	-	154	308
Derivative cash settlements	13,074	-	89	13,163
Results of operations of foreclosed assets	2,989	-	-	2,989
Total non-interest income	16,217	-	243	16,460
Non-interest expense:				
General and administrative expenses	(10,614)	(1,214)	(949)	(12,777)
Provision for guarantee liability	(1,800)	-	-	(1,800)
Derivative forward value	(47,582)	-	(1,498)	(49,080)
Foreign currency adjustments	(20,620)	-	-	(20,620)
Total non-interest expense	(80,616)	(1,214)	(2,447)	(84,277)
(Loss) income prior to income taxes and minority interest	)	529	(1,327)	(52,834)
Income taxes	-	(18)	504	486
Net (loss) income per segment reporting	\$ (52,036)	\$ 511	\$ (823)	\$ (52,348)
Reconciliation of net loss:				
Net loss per segment reporting				\$ (52,348)
Minority interest				312
Net loss per consolidated statement of operations				\$ (52,036)

The following chart contains the consolidated statement of operations for the three months ended November 30, 2005.

(in thousands)	CFC	RTFC	NCSC	Consolidated
Statement of Operations:				
Interest income	\$ 205,109	\$ 30,533	\$ 7,684	\$ 243,326
Interest expense	(201,048)	(28,749)	(6,296)	(236,093)
Net interest income	4,061	1,784	1,388	7,233
Provision for loan losses	(3,886)	-	-	(3,886)
Net interest income after provision for loan losses	175	1,784	1,388	3,347
Non-interest income:				
Rental and other income	13	-	-	13

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Derivative cash settlements	17,114	-	(298)	16,816
Results of operations of foreclosed assets	3,878	-	-	3,878
Gain on sale of building and land	37,740	-	-	37,740
Total non-interest income	58,745	-	(298)	58,447
Non-interest expense:				
General and administrative expenses	(11,081)	(1,088)	(582)	(12,751)
Provision for guarantee losses	(700)	-	-	(700)
Derivative forward value	(19,149)	-	3,433	(15,716)
Foreign currency adjustments	35,739	-	-	35,739
Total non-interest expense	4,809	(1,088)	2,851	6,572
Income prior to income taxes and minority interest	63,729	696	3,941	68,366
Income taxes	-	(34)	(1,496)	(1,530)
Net income per segment reporting	\$ 63,729	\$ 662	\$ 2,445	\$ 66,836
Reconciliation of net income:				
Net income per segment reporting				\$ 66,836
Minority interest				(3,107)
Net income per consolidated statement of operations				\$ 63,729

(14) Subsequent Events

In December 2006, the Company issued \$600 million of floating rate extendible collateral trust bonds. The bonds have an initial maturity date of January 2008 and may be extended by the holders through a final maturity date of January 2012.

In December 2006, the Company unwound two \$500 million pay variable and receive fixed interest rate exchange agreements. This transaction resulted in a \$31 million gain in derivative cash settlements and a loss of approximately the same amount in the derivative forward value. There will be no significant impact on net income as a result of this transaction.

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

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

This Form 10-Q contains forward-looking statements within the meaning of the Securities Act of 1933, as amended, and the Exchange Act of 1934, as amended. Forward-looking statements, which are based on certain assumptions and describe our future plans, strategies and expectations, are generally identified by our use of words such as "intend," "plan," "may," "should," "will," "project," "estimate," "anticipate," "believe," "expect," "continue," "potential," "opportunity," and similar expressions, whether in the negative or affirmative. All statements that address expectations or projections about the future, including statements about loan growth, the adequacy of the loan loss allowance, net income growth, leverage and debt to equity ratios, and borrower financial performance are forward-looking statements. Although we believe that the expectations reflected in our forward-looking statements are based on reasonable assumptions, actual results and performance could differ materially from those set forth in the forward-looking statements. Factors that could cause future results to vary from current expectations include, but are not limited to, general economic conditions, legislative changes, governmental monetary and fiscal policies, changes in tax policies, changes in interest rates, the cost of funds, demand for our loan products, changes in the quality or composition of our loan and investment portfolios, changes in accounting principles, policies or guidelines, and other economic and governmental factors affecting our operations. Some of these and other factors are discussed in our annual and quarterly reports previously filed with the Securities and Exchange Commission ("SEC"). Except as required by law, we undertake no obligation to update or publicly release any revisions to forward-looking statements to reflect events, circumstances or changes in expectations after the date on which the statement is made.

The information contained in this section should be read in conjunction with our consolidated financial statements and related notes and the information contained elsewhere in this Form 10-Q, in addition to Part I, Item 1A, Risk Factors in the Company's Form 10-K for the year ended May 31, 2006.

#### Overview

In this report the Company will provide analysis on its results of operations, financial condition, liquidity and market risk. The Company will also provide analysis of trends and significant transactions completed in the period covered by the report.

The Company provides financial products to its rural electric and telecommunications members at the lowest cost in relation to the financial performance and strength required to maintain strong credit ratings. The Company's access to the capital markets at levels that allow it to keep cost to the members low is dependent on maintaining strong credit ratings. See page 51 for detail on the current ratings for the Company's public debt.

#### Financial Overview

##### Results of Operations

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

For the six months ended November 30, 2006, the Company reported a net loss of \$92 million, thus the TIER calculation resulted in a value below 1.00, compared to a net income of \$58 million and a 1.12 TIER for the prior year period. For the six months ended November 30, 2005, the Company reported an adjusted net income of \$34 million and adjusted TIER of 1.07, compared to an adjusted net income of \$79 million and adjusted TIER of 1.18 for the prior year period. See "Non-GAAP Financial Measures" for more information on the adjustments the Company makes to its financial results for the purposes of its own analysis and covenant compliance.

During the six months ended November 30, 2006, earnings were impacted by a \$110 million decrease in derivative and foreign currency adjustments, which was primarily impacted by the rise in interest rates. During the six months ended November 30, 2005, CFC sold its headquarters facility and recognized a gain of \$38 million on the sale in that period.

Over the remainder of fiscal year 2007, the Company anticipates that the net interest income yield will remain at about the current level, as it is anticipated that the increases to the federal funds interest rate are nearing an end. The level of loans on non-accrual is expected to continue to be a significant drag on earnings for fiscal year 2007.

#### Financial Condition

At November 30, 2006, the Company's total loans outstanding decreased by \$203 million or 1% from May 31, 2006. At that date, RTFC loans outstanding decreased by \$145 million, CFC loans outstanding decreased by \$56 million and NCSC loans decreased by \$2 million from May 31, 2006.

The Company expects that the balance of the loan portfolio will remain relatively stable during the remainder of fiscal year 2007. Loans from the Federal Financing Bank ("FFB"), an agency of the U.S. Treasury Department, with a Rural Utilities Service ("RUS") guarantee, represent a lower cost option for rural electric utilities compared to the Company. The Company anticipates that the majority of its electric loan growth will come from distribution system borrowers that have fully prepaid their RUS loans and choose not to return to the government loan program, from distribution system borrowers that do not want to wait the 12 to 24 months it may take RUS to process and fund the loan and from power supply systems. The Company anticipates that the RTFC loan balance will continue to decline due to long-term loan amortization and lower levels of capital expenditure requirements and asset acquisitions in the rural telecommunications marketplace.

During the six months ended November 30, 2006, short-term debt decreased by \$151 million and long-term debt decreased by \$245 million. Short-term debt decreased due to the redemption and maturity of long-term debt offset by long-term debt reclassified to short-term debt based on the related maturity date and an increase in commercial paper.

Total equity decreased \$177 million from May 31, 2006 to November 30, 2006 due to CFC's retirement of \$84 million of patronage capital to its members and a net loss of \$92 million for the six months ended November 30, 2006. Under GAAP, the Company's reported equity balance fluctuates based on the impact of future expected changes to interest rates on the fair value of its interest rate exchange agreements and the impact of future expected currency exchange rates on its currency exchange agreements. As a result, it is difficult to predict the future changes in the Company's reported GAAP equity due to the uncertainty of the movement in future interest and currency exchange rates. In its internal analysis and for purposes of covenant compliance under its credit agreements, the Company adjusts equity to exclude the non-cash impacts of Statement of Financial Accounting Standards ("SFAS") 133, Accounting for Derivative Instruments and Hedging Activities, as amended and SFAS 52, Foreign Currency Translation.

#### Liquidity

At November 30, 2006, the Company had \$3,491 million of commercial paper, daily liquidity fund and bank bid notes and \$1,702 million of medium-term notes, collateral trust bonds and long-term notes payable scheduled to mature during the next twelve months. Members held commercial paper (including the daily liquidity fund) totaling \$1,624 million or approximately 48% of the total commercial paper outstanding at November 30, 2006. Commercial paper issued through dealers and bank bid notes totaled \$1,725 million and represented 10% of total debt outstanding at November 30, 2006. The Company intends to maintain the balance of dealer commercial paper and bank bid notes at 15% or less of total debt outstanding during fiscal year 2007. During the next twelve months, the Company plans to refinance the \$1,702 million of medium-term notes, collateral trust bonds and long-term notes payable and fund new loan growth by issuing a combination of commercial paper, medium-term notes, collateral trust bonds and other debt.

CFC uses member loan repayments, capital market debt issuance, private debt issuance, member investments, and net income to fund its operations. In addition, the Company maintains both short-term and long-term bank lines in the form of revolving credit agreements with its bank group. Members pay a small membership fee and are typically required to purchase subordinated certificates as a condition to receiving a long-term loan advance



and as a condition of membership. CFC has a need for funding to make loan advances to its members, to make interest payments on its public and private debt and to make payments of principal on its maturing debt. To facilitate access to the capital markets, CFC is a regular issuer of debt in the capital markets, maintains strong credit ratings and has active shelf registrations on file with the SEC for each of its public debt instruments. CFC also has access to foreign debt markets with Euro medium-term note and commercial paper programs and an Australian medium-term note program.

The Company can borrow amounts from the FFB with a guarantee of repayment by the RUS as part of the funding mechanism for the Rural Economic Development Loan and Grant ("REDLG") program. As a result of the RUS guarantee, these funds represent a lower cost compared to the Company's other forms of debt securities. At November 30, 2006, the Company had RUS approval to borrow an additional \$500 million under the REDLG program and the Company anticipates borrowing this amount prior to the expiration of the commitment in July 2009.

## Results of Operations

-  
Six Months Ended November 30, 2006 versus November 30, 2005

The following chart presents the results of operations for the six months ended November 30, 2006 versus November 30, 2005.

(Dollar amounts in millions)	For the six months ended November 30,		Increase/ (Decrease)
	2006	2005	
Interest income	\$ 525	\$ 493	\$ 32
Interest expense	(498)	(471)	(27)
Net interest income	27	22	5
Provision for loan losses	-	(4)	4
Net interest income after provision for loan losses	27	18	9
Non-interest income:			
Rental and other income	1	1	-
Derivative cash settlements	25	37	(12)
Results of operations of foreclosed assets	6	9	(3)
Gain on sale of building and land	-	38	(38)
Total non-interest income	32	85	(53)
Non-interest expense:			
Salaries and employee benefits	(17)	(16)	(1)
Other general and administrative expenses	(9)	(9)	-
Recovery of guarantee liability	-	3	(3)
Derivative forward value	(110)	(51)	(59)
Foreign currency adjustments	(17)	34	(51)
Total non-interest expense	(153)	(39)	(114)
(Loss) income prior to income taxes and minority interest	(94)	64	(158)
Income taxes	1	(2)	3
Minority interest	1	(4)	5
Net (loss) income	\$ (92)	\$ 58	\$ (150)
TIER (1)	-	1.12	
Adjusted TIER (2)	1.07	1.18	

(1) For the six months ended November 30, 2006, the Company reported a net loss of \$92 million thus the TIER calculation results in a value below 1.00.

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

The following chart summarizes the Company's operating results expressed as an annualized percentage of average loans outstanding.

	For the six months ended November 30,		Increase/ (Decrease)
	2006	2005	
Interest income	5.72 %	5.35 %	0.37 %
Interest expense	(5.42 )%	(5.11 )%	(0.31 )%
Net interest income	0.30 %	0.24 %	0.06 %
Provision for loan losses	-	(0.04 )%	0.04 %
Net interest income after provision for loan losses	0.30 %	0.20 %	0.10 %
Non-interest income:			
Rental and other income	0.01 %	0.01 %	-
Derivative cash settlements	0.27 %	0.40 %	(0.13 )%
Results of operations of foreclosed assets	0.07 %	0.10 %	(0.03 )%
Gain on sale of building and land	-	0.41 %	(0.41 )%
Total non-interest income	0.35 %	0.92 %	(0.57 )%
Non-interest expense:			
Salaries and employee benefits	(0.19 )%	(0.17 )%	(0.02 )%
Other general and administrative expenses	(0.10 )%	(0.10 )%	-
Recovery of guarantee liability	-	0.03 %	(0.03 )%
Derivative forward value	(1.20 )%	(0.56 )%	(0.64 )%
Foreign currency adjustments	(0.18 )%	0.37 %	(0.55 )%
Total non-interest expense	(1.67 )%	(0.43 )%	(1.24 )%
(Loss) income prior to income taxes and minority interest	(1.02 )%	0.69 %	(1.71 )%
Income taxes	0.01 %	(0.02 )%	0.03 %
Minority interest	0.01 %	(0.04 )%	0.05 %
Net (loss) income	(1.00 )%	0.63 %	(1.63 )%
Adjusted net interest income (1)	0.57 %	0.64 %	(0.07 )%
Adjusted income prior to income taxes and minority interest (2)	0.36 %	0.47 %	(0.11 )%

(1) Adjusted to include derivative cash settlements in the interest expense. See "Non-GAAP Financial Measures" for further explanation and a reconciliation of these adjustments.

(2) Adjusted to exclude derivative forward value and foreign currency adjustments. See "Non-GAAP Financial Measures" for further explanation and a reconciliation of these adjustments. For the six months ended November 30, 2005, also adjusted to exclude the gain on sale of building and land.

CFC's net interest income will increase or decrease due to changes in loan volume and the rate that it receives on its loans and pays on its sources of funding, respectively. CFC's loan volume substantially determines its funding needs. The following Volume Rate Variance Table provides a breakout of the change to interest income, interest expense and net interest income due to changes in loan volume versus changes to interest rates. The analysis is consistent with the November 30, 2006 and 2005 consolidated statements of operations. For comparability purposes, average daily loan volume is used as the denominator in calculating interest income yield, interest expense rates and net interest income yield.

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

Volume Rate Variance Table  
(Dollar amounts in millions)

	For the six months ended November 30,								
	2006			2005			Change due to		
	Average Loan Balance	Income / (Cost)	Rate	Average Loan Balance	Income / (Cost)	Rate	Volume (1)	Rate (2)	Total
<b>Interest income</b>									
CFC	\$ 16,404	\$ 454	5.52%	\$ 16,012	\$ 408	5.08%	\$ 10	\$ 36	\$ 46
RTFC	1,510	55	7.32%	1,925	70	7.27%	(15)	-	(15)
NCSC	398	16	7.66%	447	15	6.77%	(1)	2	1
Total	\$ 18,312	\$ 525	5.72%	\$ 18,384	\$ 493	5.35%	\$ (6)	\$ 38	\$ 32
<b>Interest expense</b>									
CFC	\$ 16,404	\$ (432)	(5.25)%	\$ 16,012	\$ (393)	(4.89)%	\$ (9)	\$ (30)	\$ (39)
RTFC	1,510	(52)	(6.88)%	1,925	(66)	(6.89)%	14	-	14
NCSC	398	(14)	(6.81)%	447	(12)	(5.53)%	1	(3)	(2)
Total	\$ 18,312	\$ (498)	(5.42)%	\$ 18,384	\$ (471)	(5.11)%	\$ 6	\$ (33)	\$ (27)
<b>Net interest income</b>									
CFC	\$ 16,404	\$ 22	0.27%	\$ 16,012	\$ 15	0.19%	\$ 1	\$ 6	\$ 7
RTFC	1,510	3	0.44%	1,925	4	0.38%	(1)	-	(1)
NCSC	398	2	0.85%	447	3	1.24%	-	(1)	(1)
Total	\$ 18,312	\$ 27	0.30%	\$ 18,384	\$ 22	0.24%	\$ -	\$ 5	\$ 5
<b>Derivative cash settlements</b>									
(3)									
CFC	\$ 12,635	\$ 25	0.39%	\$ 15,257	\$ 38	0.49%	\$ (6)	\$ (7)	\$ (13)
NCSC	95	-	-	116	(1)	(1.29)%	-	1	1
Total	\$ 12,730	\$ 25	0.39%	\$ 15,373	\$ 37	0.48%	\$ (6)	\$ (6)	\$ (12)
<b>Adjusted interest expense</b>									
(4)									
Total	\$ 18,312	\$ (473)	(5.15)%	\$ 18,384	\$ (434)	(4.71)%	\$ -	\$ (39)	\$ (39)

(1) Variance due to volume is calculated using the following formula: ((current average balance - prior year average balance) x prior year rate).

(2) Variance due to rate is calculated using the following formula: ((current rate - prior year rate) x current average balance).

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

(4) See "Non-GAAP Financial Measures" for further explanation of the adjustment the Company makes in its financial analysis to include the derivative cash settlements in its interest expense.

Interest Income

Total interest income reported on the consolidated statements of operations and shown in the chart above includes the following as a percentage of average loans outstanding:

(Dollar amounts in millions)	For the six months ended November 30,		2005		Increase/ (Decrease)
	2006		2005		
	Amount	Rate	Amount	Rate	
Interest on long-term fixed rate loans (1)	\$ 412		\$ 361		\$ 51
Interest on long-term variable rate loans (1)	62		88		(26)
Interest on short-term loans (1)	36		25		11
Total interest income on loans	510	5.56 %	474	5.14%	36
Interest on investments (2)	3	0.03 %	5	0.06%	(2)
Conversion fees (3)	5	0.06 %	7	0.08%	(2)
Make-whole and prepayment fees (4)	1	0.01 %	4	0.04%	(3)
Commitment and guarantee fees (5)	5	0.05 %	3	0.03%	2
Other fees (6)	1	0.01 %	-	-	1
	\$ 525	5.72 %	\$ 493	5.35%	\$ 32

Total interest income

(1) Represents interest income on loans to members.

(2) Represents interest income on the investment of cash.

(3) Conversion fees are deferred and recognized using the interest method over the remaining term of the original loan interest rate pricing term, except for a small portion of the total fee charged to cover administrative costs related to the conversion which is recognized immediately.

(4) Make-whole and prepayment fees are charged for the early repayment of principal in full and are recognized when collected.

(5) Commitment fees for RTFC loan commitments are, in most cases, refundable on a prorata basis according to the amount of the loan commitment that is advanced. Such refundable fees are deferred and then recognized on a prorata basis based on the portion of the loan that is not advanced prior to the expiration of the commitment. Commitment fees on CFC loan commitments are not refundable and are billed and recognized based on the unused portion of committed lines of credit. Guarantee fees are charged based on the amount, type and term of the guarantee. Guarantee fees are deferred and amortized using the straight-line method into interest income over the life of the guarantee.

(6) Other fees include late payment fees charged on late loan payments and recognized when collected and other fees associated with syndication of loans that are deferred and amortized using the straight-line method. Additionally, other fees include loan origination fees that are deferred and amortized over the life of the facility as an addition to interest income using the straight-line method which approximates the interest method.

The \$32 million or 6% increase to the total interest income for the six months ended November 30, 2006 as compared to the prior year period was due to the increase to CFC loan interest rates in the markets offset by lower loan volume. Since November 30, 2005, the Company raised variable interest rates by approximately 120 basis points, while fixed interest rates remained relatively stable. For the six months ended November 30, 2006, the Company had a reduction to interest income of \$41 million due to non-accrual loans compared to a reduction of \$38 million for the prior year period. The decrease in loan volume is due to the further reduction of RTFC loans during the six months ended November 30, 2006.

The \$46 million increase in CFC interest income was due to the increase in interest rates and loan volume partly offset by the impact of non-accrual loans. The impact on CFC interest income of non-accrual loans was a reduction of \$20 million for the six months ended November 30, 2006 as compared to \$17 million for the prior year period. The impact of non-accrual loans on interest income is included in the rate variance in the chart above. The \$15 million decrease in RTFC interest income was due to the reduction in the balance of RTFC loans outstanding. The impact on RTFC interest income of non-accrual loans was a reduction of \$21 million for the six months ended November 30, 2006 and 2005.

#### Interest Expense

Total interest expense reported on the consolidated statements of operations and shown in the chart above includes the following as a percentage of average loans outstanding:

	For the six months ended November 30,				Increase/ (Decrease)
	2006		2005		
(Dollar amounts in millions)	Amount	Rate	Amount	Rate	
Interest expense - commercial paper and bid notes (1)	\$ 96		\$ 57		\$ 39
Interest expense - medium-term notes (1)	181		203		(22)
Interest expense - collateral trust bonds (1)	101		140		(39)
Interest expense - subordinated deferrable debt (1)	17		24		(7)
Interest expense - subordinated certificates (1)	24		23		1
Interest expense - long-term private debt (1)	60		13		47

Total interest expense on debt	479	5.22%	460	4.99%	19
Debt issuance costs (2)	10	0.11%	6	0.07%	4
Derivative cash settlements, net (3)	-	-	2	0.02%	(2)
Commitment and guarantee fees (4)	7	0.07%	2	0.02%	5
Other fees (5)	2	0.02%	1	0.01 %	1
Total interest expense	\$ 498	5.42%	\$ 471	5.11%	\$ 27

(1) Represents interest expense and the amortization of discounts on the debt security.

(2) Includes amortization of all deferred charges related to debt issuance, 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 and debt issuance costs fully amortized as part of the early retirement of debt.

(3) Represents the net cost related to swaps that qualify for hedge treatment plus the accrual from the date of the last settlement to the current period end.

(4) Includes various fees related to funding activities, including fees paid to banks participating in the Company's revolving credit agreements and fees paid under bond guarantee agreements with RUS as part of the REDLG program. Fees are recognized as incurred or amortized on a straight-line basis over the life of the respective agreement.

(5) Represents fees associated with NCSC's consumer loan program and other fees.

The \$27 million increase to the total interest expense for the six months ended November 30, 2006 as compared to the prior year period was due to the increase to interest rates in the markets and an increase to fees expensed primarily due to the \$5 million charge to write-off the unamortized issuance costs on the early retirement of subordinated deferrable debt in June 2006.

The adjusted interest expense, which includes all derivative cash settlements, for the six months ended November 30, 2006 increased by \$39 million compared to the prior year period due to the \$27 million increase to interest expense noted above and the \$12 million decrease in derivative cash settlements described below. See "Non-GAAP Financial Measures" for further explanation of the adjustment the Company makes in its financial analysis to include all derivative cash settlements in its interest expense.



#### Net Interest Income

The change in the line items described above resulted in an increase in net interest income of \$5 million for the six months ended November 30, 2006 compared to the prior year period. The adjusted net interest income, which includes all derivative cash settlements, for the six months ended November 30, 2006 was \$52 million, a decrease of \$7 million from the prior year period. See "Non-GAAP Financial Measures" for further explanation of the adjustment the Company makes in its financial analysis to include all derivative cash settlements in its interest expense, and therefore net interest income.

#### Derivative Cash Settlements

The \$12 million decrease in cash settlements for the six months ended November 30, 2006 compared to the prior year period is due to both a decrease to the net rate earned by the Company on exchange agreements and the reduction in the average notional amount of derivatives outstanding as compared to the prior year period.

#### Results of Operations of Foreclosed Assets

Income from the operation of foreclosed assets decreased by \$3 million for the six months ended November 30, 2006 compared to the prior year period due to the gain of \$3 million related to the sale of real estate assets in August 2005. At November 30, 2006, the remaining balance of foreclosed assets is comprised of notes receivable which the Company continues to service.

#### Gain on Sale of Building and Land

On October 18, 2005, CFC closed on the sale of its headquarters facility in Fairfax County, Virginia to an affiliate of Prentiss Properties Acquisition Partners, L.P. resulting in a gain of \$38 million for the six months ended November 30, 2005. An additional gain of \$5 million was recognized during the remainder of fiscal year 2006 due to the release of funds held in escrow and net of additional payments for transaction related expenses.

#### Recovery of Guarantee Liability

There was no change to the guarantee liability for the six months ended November 30, 2006 compared to a recovery of \$3 million in the prior year period. For the six months ended November 30, 2006 and 2005, substantially all guarantees were issued by CFC.

#### *Derivative Forward Value*

The \$59 million decrease in the derivative forward value during the six months ended November 30, 2006 compared to the prior year period is due to changes in the estimate of future interest rates over the remaining life of the derivative contracts and a 17% reduction in the average notional amount of derivatives outstanding.

#### Foreign Currency Adjustment

The Company's foreign currency adjustment for the six months ended November 30, 2006 decreased by \$51 million compared to the prior year period. A significant increase in the value of the Euro versus the value of the U.S. dollar during the six months ended November 30, 2006 resulted in an increase in the recorded U.S. dollar value of foreign denominated debt and therefore a charge to expense on the consolidated statements of operations. During the prior period quarter, there was a decrease in the exchange rate between the Euro and the U.S. dollar.

#### Net Loss

The change in the line items described above resulted in a net loss of \$92 million for the six months ended November 30, 2006 compared to net income of \$58 million for the prior year period. The adjusted net income, which excludes the impact of the derivative forward value and foreign currency adjustments and adds back minority interest, was \$34 million, compared to \$79 million for the prior year period. The adjusted net income for the six months ended November 30, 2005 included a \$38 million gain on the sale of the building. The adjusted net income for the six months ended November 30, 2005, excluding the gain on the sale of the building, was \$41 million. See "Non-GAAP Financial Measures" for further explanation of the adjustments the Company makes in its financial analysis to net income.



Three Months Ended November 30, 2006 versus November 30, 2005

The following chart presents the results of operations for the three months ended November 30, 2006 versus November 30, 2005.

(Dollar amounts in millions)	For the three months ended		Increase/ (Decrease)
	2006	November 30, 2005	
Interest income	\$ 260	\$ 243	\$ 17
Interest expense	(245)	(236)	(9)
Net interest income	15	7	8
Provision for loan losses	-	(4)	4
Net interest income after provision for loan losses	15	3	12
Non-interest income:			
Rental and other income	1	-	1
Derivative cash settlements	13	17	(4)
Results of operations of foreclosed assets	3	4	(1)
Gain on sale of building and land	-	38	(38)
Total non-interest income	17	59	(42)
Non-interest expense:			
Salaries and employee benefits	(8)	(8)	-
Other general and administrative expenses	(5)	(5)	-
Provision for guarantee liability	(2)	-	(2)
Derivative forward value	(50)	(16)	(34)
Foreign currency adjustments	(20)	35	(55)
Total non-interest expense	(85)	6	(91)
Income prior to income taxes and minority interest	(53)	68	(121)
Income taxes	-	(2)	2
Minority interest	1	(3)	4
Net income	\$ (52)	\$ 63	\$(115)
TIER (1)	-	1.27	
Adjusted TIER (2)	1.07	1.21	

(1) For the three months ended November 30, 2006, the Company reported a net loss of \$52 million thus the TIER calculation results in a value below 1.00.

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

The following chart summarizes the Company's operating results expressed as an annualized percentage of average loans outstanding.

	For the three months ended November 30,		Increase/ (Decrease)
	2006	2005	
Interest income	5.71%	5.38%	0.33%
Interest expense	(5.38)%	(5.23)%	(0.15)%
Net interest income	0.33%	0.15%	0.18%
Provision for loan losses	-	(0.09)%	0.09%
Net interest income after provision for loan losses	0.33%	0.06%	0.27%
Non-interest income:			
Rental and other income	0.02%	-	0.02%
Derivative cash settlements	0.29%	0.38%	(0.09)%
Results of operations of foreclosed assets	0.07%	0.09%	(0.02)%
Gain on sale of building and land	-	0.84%	(0.84)%
Total non-interest income	0.38%	1.31%	(0.93)%
Non-interest expense:			
Salaries and employee benefits	(0.18)%	(0.18)%	-
Other general and administrative expenses	(0.11)%	(0.11)%	-
Provision for guarantee liability	(0.04)%	-	(0.04)%
Derivative forward value	(1.10)%	(0.35)%	(0.75)%
Foreign currency adjustments	(0.44)%	0.78%	(1.22)%
Total non-interest expense	(1.87)%	0.14%	(2.01)%
(Loss) income prior to income taxes and minority interest	(1.16)%	1.51%	(2.67)%
Income taxes	-	(0.04)%	0.04%
Minority interest	0.02%	(0.07)%	0.09%
Net (loss) income	(1.14)%	1.40%	(2.54)%
Adjusted net interest income (1)	0.62%	0.53%	0.09%
Adjusted income prior to income taxes and minority interest (2)	0.38%	0.24%	0.14%

(1) Adjusted to include derivative cash settlements in the interest expense. See "Non-GAAP Financial Measures" for further explanation and a reconciliation of these adjustments.

(2) Adjusted to exclude derivative forward value and foreign currency adjustments. See "Non-GAAP Financial Measures" for further explanation and a reconciliation of these adjustments. For the three months ended November 30, 2005, also adjusted to exclude the gain on sale of building and land.

CFC's net interest income will increase or decrease due to changes in loan volume and the rate that it receives on its loans and pays on its sources of funding, respectively. CFC's loan volume substantially determines its funding needs. The following Volume Rate Variance Table provides a breakout of the change to interest income, interest expense and net interest income due to changes in loan volume versus changes to interest rates. The analysis is consistent with the November 30, 2006 and 2005 consolidated statements of operations. For comparability purposes, average daily loan

volume is used as the denominator in calculating interest income yield, interest expense rates and net interest income yield.

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

Volume Rate Variance Table  
(Dollar amounts in millions)

For the three months

ended November 30,

	2006			2005			Change due to		
	Average Loan Balance	Income / (Cost)	Rate	Average Loan Balance	Income / (Cost)	Rate	Volume (1)	Rate (2)	Total
<b>Interest income</b>									
CFC	\$ 16,384	\$ 225	5.51%	\$ 15,928	\$ 205	5.16%	\$ 6	\$ 14	\$ 20
RTFC	1,484	27	7.38%	1,725	30	7.10%	(4)	1	(3)
NCSC	399	8	7.75%	440	8	7.00%	(1)	1	-
Total	\$ 18,267	\$ 260	5.71%	\$ 18,093	\$ 243	5.38%	\$ 1	\$ 16	\$ 17
<b>Interest expense</b>									
CFC	\$ 16,384	\$ (213)	(5.21)%	\$ 15,928	\$ (202)	(5.06)%	\$ (5)	\$ (6)	\$ (11)
RTFC	1,484	(25)	(6.91)%	1,725	(28)	(6.69)%	4	(1)	3
NCSC	399	(7)	(6.87)%	440	(6)	(5.73)%	1	(2)	(1)
Total	\$ 18,267	\$ (245)	(5.38)%	\$ 18,093	\$ (236)	(5.23)%	\$ -	\$ (9)	\$ (9)
<b>Net interest income</b>									
CFC	\$ 16,384	\$ 12	0.30%	\$ 15,928	\$ 3	0.10%	\$ 1	\$ 8	\$ 9
RTFC	1,484	2	0.47%	1,725	2	0.41%	-	-	-
NCSC	399	1	0.88%	440	2	1.27%	-	(1)	(1)
Total	\$ 18,267	\$ 15	0.33%	\$ 18,093	\$ 7	0.15%	\$ 1	\$ 7	\$ 8
<b>Derivative cash settlements</b>									
(3)									
CFC	\$ 12,828	\$ 13	0.41%	\$ 15,486	\$ 17	0.44%	\$ (3)	\$ (1)	\$ (4)
NCSC	93	-	-	114	-	-	-	-	-
Total	\$ 12,921	\$ 13	0.41%	\$ 15,600	\$ 17	0.43%	\$ (3)	\$ (1)	\$ (4)
<b>Adjusted interest expense</b>									
(4)									
Total	\$ 18,267	\$ (232)	(5.09)%	\$ 18,093	\$ (219)	(4.85)%	\$ (3)	\$ (10)	\$ (13)

(1) Variance due to volume is calculated using the following formula: ((current average balance - prior year average balance) x prior year rate).

(2) Variance due to rate is calculated using the following formula: ((current rate - prior year rate) x current average balance).

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

(4) See "Non-GAAP Financial Measures" for further explanation of the adjustment the Company makes in its financial analysis to include the derivative cash settlements in its interest expense.

## Interest Income

Total interest income reported on the consolidated statements of operations and shown in the chart above includes the following as a percentage of average loans outstanding:

(Dollar amounts in millions)	For the three months ended November 30,				Increase/ (Decrease)
	2006		2005		
	Amount	Rate	Amount	Rate	\$
Interest on long-term fixed rate loans (1)	\$ 206		\$ 185		\$ 21
Interest on long-term variable rate loans (1)	31		38		(7)
Interest on short-term loans (1)	18		13		5
Total interest income on loans	255	5.60 %	236	5.23%	19
Interest on investments (2)	1	0.02 %	2	0.04%	(1)
Conversion fees (3)	3	0.07 %	3	0.07%	-
Commitment and guarantee fees (4)	1	0.02 %	2	0.04%	(1)
	\$ 260	5.71 %	\$ 243	5.38%	\$ 17

Total interest income

(1) Represents interest income on loans to members.

(2) Represents interest income on the investment of cash.

(3) Conversion fees are deferred and recognized using the interest method over the remaining term of the original loan interest rate pricing term, except for a small portion of the total fee charged to cover administrative costs related to the conversion which is recognized immediately.

(4) Commitment fees for RTFC loan commitments are, in most cases, refundable on a prorata basis according to the amount of the loan commitment that is advanced. Such refundable fees are deferred and then recognized on a prorata basis based on the portion of the loan that is not advanced prior to the expiration of the commitment. Commitment fees on CFC loan commitments are not refundable and are billed and recognized based on the unused portion of committed lines of credit. Guarantee fees are charged based on the amount, type and term of the guarantee. Guarantee fees are deferred and amortized using the straight-line method into interest income over the life of the guarantee.

The \$17 million or 7% increase to the total interest income for the quarter ended November 30, 2006 as compared to the prior year period was due to the increase to CFC loan interest rates. Since November 30, 2005, the Company raised variable interest rates by approximately 120 basis points, while fixed interest rates remained relatively stable. For the quarter ended November 30, 2006, the Company had a reduction to interest income of \$20 million due to non-accrual loans compared to a reduction of \$19 million for the prior year period.

The \$20 million increase in CFC interest income was due to the increase in interest rates on CFC loans and the increase in CFC loans outstanding partly offset by the impact of non-accrual loans. The impact on CFC interest income of non-accrual loans was a reduction of \$10 million for the quarter ended November 30, 2006 as compared to \$9 million for the prior year period. The impact of non-accrual loans on interest income is included in the rate variance in the chart above. The \$3 million decrease in RTFC interest income was due to the reduction in the balance of RTFC loans outstanding. The impact on RTFC interest income of non-accrual loans was a reduction of \$10 million for the quarter ended November 30, 2006 and 2005.

### Interest Expense

Total interest expense reported on the consolidated statements of operations and shown in the chart above includes the following as a percentage of average loans outstanding:

(Dollar amounts in millions)	For the three months ended November 30,				Increase/ (Decrease)
	2006		2005		
	Amount	Rate	Amount	Rate	
Interest expense - commercial paper and bid notes (1)	\$ 49		\$ 25		\$ 24
Interest expense - medium-term notes (1)	90		102		(12)
Interest expense - collateral trust bonds (1)	50		70		(20)
Interest expense - subordinated deferrable debt (1)	8		12		(4)
Interest expense - subordinated certificates (1)	12		12		-
Interest expense - long-term private debt (1)	30		10		20
Total interest expense on debt	239	5.25 %	231	5.12%	8
Debt issuance costs (2)	2	0.04 %	3	0.07%	(1)
Derivative cash settlements, net (3)	-	-	1	0.02%	(1)
Commitment and guarantee fees (4)	4	0.09 %	1	0.02%	3
Total interest expense	\$ 245	5.38 %	\$ 236	5.23%	\$ 9

(1) Represents interest expense and the amortization of discounts on the debt security.

(2) Includes amortization of all deferred charges related to debt issuance, 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 and debt issuance costs fully amortized as part of the early retirement of debt.

(3) Represents the net cost related to swaps that qualify for hedge treatment plus the accrual from the date of the last settlement to the current period end.



(4) Includes various fees related to funding activities, including fees paid to banks participating in the Company's revolving credit agreements and fees paid under bond guarantee agreements with RUS as part of the REDLG program. Fees are recognized as incurred or amortized on a straight-line basis over the life of the respective agreement.

The \$9 million increase to the total interest expense for the quarter ended November 30, 2006 as compared to the prior year period was due to the increase to interest rates in the markets during the quarter ended November 30, 2006. The increase to total interest expense was partly offset by the decrease due to lower loan volume.

The adjusted total interest expense, which includes all derivative cash settlements, for the quarter ended November 30, 2006 increased by \$13 million compared to the prior year period due to the \$9 million increase to interest expense noted above and the \$4 million decrease in derivative cash settlements described below. See "Non-GAAP Financial Measures" for further explanation of the adjustment the Company makes in its financial analysis to include all derivative cash settlements in its interest expense.

#### Net Interest Income

The change in the line items described above resulted in an increase in net interest income of \$8 million for the quarter ended November 30, 2006 compared to the prior year period. The adjusted net interest income, which includes all derivative cash settlements, for the quarter ended November 30, 2006 was \$28 million, an increase of \$4 million from the prior year period. See "Non-GAAP Financial Measures" for further explanation of the adjustment the Company makes in its financial analysis to include all derivative cash settlements in its interest expense, and therefore net interest income.

#### Derivative Cash Settlements

The \$4 million decrease in cash settlements for the quarter ended November 30, 2006 compared to the prior year period is primarily due to a reduction in the average notional amount of derivatives outstanding as compared to the prior year period. In addition, there was a decrease to the net rate earned by the Company on exchange agreements.

### Results of Operations of Foreclosed Assets

Income from the operation of foreclosed assets decreased by \$1 million for the quarter ended November 30, 2006 compared to the prior year period due to the \$1 million additional gain recognized during the prior year period related to the sale of real estate assets in August 2005. At November 30, 2006, the remaining balance of foreclosed assets is comprised of notes receivable which the Company continues to service.

### Gain on Sale of Building and Land

On October 18, 2005, CFC closed on the sale of its headquarters facility in Fairfax County, Virginia to an affiliate of Prentiss Properties Acquisition Partners, L.P. resulting in a gain of \$38 million for the quarter ended November 30, 2005. An additional gain of \$5 million was recognized during the remainder of fiscal year 2006 due to the release of funds held in escrow and net of additional payments for transaction related expenses.

### Provision for Guarantee Liability

There was a provision of \$2 million to the guarantee liability for the quarter ended November 30, 2006 compared to no change in the prior year period. For the quarter November 30, 2006 and 2005, substantially all guarantees were issued by CFC.

### Derivative Forward Value

The \$34 million decrease in the derivative forward value during the quarter ended November 30, 2006 compared to the prior year period is due to changes in the estimate of future interest rates over the remaining life of the derivative contracts and a 17% reduction to the average notional amount of derivatives outstanding.

### Foreign Currency Adjustment

The Company's foreign currency adjustment for the quarter ended November 30, 2006 decreased by \$55 million compared to the prior year period. A significant increase in the value of the Euro versus the value of the U.S. dollar during the quarter ended November 30, 2006 resulted in an increase in the recorded U.S. dollar value of foreign denominated debt and therefore a charge to expense on the consolidated statements of operations. During the prior period quarter, there was a decrease in the exchange rate between the Euro and the U.S. dollar.

### Net Loss

The change in the line items described above resulted in a net loss of \$52 million for the quarter ended November 30, 2006 compared to net income of \$63 million for the prior year period. The adjusted net income, which excludes the impact of the derivative forward value and foreign currency adjustments and adds back minority interest, was \$17 million compared to \$47 million for the prior year period. The adjusted net income for the quarter ended November 30, 2005 included a \$38 million gain on the sale of the building. The adjusted net income for the quarter ended November 30, 2005, excluding the gain on the sale of the building, was \$9 million. See "Non-GAAP Financial Measures" for further explanation of the adjustments the Company makes in its financial analysis to net income.

### Ratio of Earnings to Fixed Charges

The following chart provides the calculation of the ratio of earnings to fixed charges for the six months ended November 30, 2006 and 2005. The ratio of earnings to fixed charges is the same calculation as TIER. See the Results of Operations for discussion on TIER and adjustments that the Company makes to the TIER calculation.

(Dollar amounts in thousands)	Three months ended November 30,		Six months ended November 30,	
	2006	2005	2006	2005
Income prior to cumulative effect of change in accounting principle	\$ (52,036)	\$ 63,729	\$ (92,158)	\$ 58,412
Add: fixed charges	245,261	236,093	497,716	471,370
Earnings available for fixed charges	\$ 193,225	\$ 299,822	\$ 405,558	\$ 529,782

Total fixed charges:

Interest on all debt (including  
amortization of

discount and issuance costs)	\$	245,261	\$	236,093	\$	497,716	\$	471,370
Ratio of earnings to fixed charges (1)		-		1.27		-		1.12

(1) For the three and six months ended November 30, 2006, earnings were insufficient to cover fixed charges by \$52 million and \$92 million, respectively.

## Financial Condition

## Loan and Guarantee Portfolio Assessment

## Loan Programs

Loans to members bear interest at rates determined from time to time by the Company after considering its interest expense, operating expenses, provision for loan losses and the maintenance of reasonable earnings levels. In keeping with its not-for-profit, cooperative charter, the Company's policy is to set interest rates at the lowest levels it considers to be consistent with sound financial management.

The following chart summarizes loans by type and by segment:

(Dollar amounts in millions)	Loans by Type				Increase/ (Decrease)
	November 30, 2006		May 31, 2006		
Long-term loans (1):					
Long-term fixed rate loans	\$ 14,743	81%	\$ 14,763	80%	\$ (20)
Long-term variable rate loans	2,336	13%	2,570	14%	(234)
Total long-term loans	17,079	94%	17,333	94%	(254)
Short-term loans (1)	1,079	6%	1,028	6%	51
Total loans	\$ 18,158	100%	\$ 18,361	100%	\$ (203)

(Dollar amounts in millions)	Loans by Segment				Increase/ (Decrease)
	November 30, 2006		May 31, 2006		
CFC:					
Distribution	\$ 12,804	70%	\$ 12,859	70%	\$ (55)
Power supply	2,817	16%	2,811	15%	6
Statewide and associate	118	1%	125	1%	(7)
CFC Total	15,739	87%	15,795	86%	(56)
RTFC	2,017	11%	2,162	12%	(145)
NCSC	402	2%	404	2%	(2)
Total	\$ 18,158	100%	\$ 18,361	100%	\$ (203)

(1) Includes loans classified as restructured and non-performing and RUS guaranteed loans.

The Company's loans outstanding have decreased \$203 million or 1% during the six months ended November 30, 2006. Long-term fixed rate loans at November 30, 2006 and May 31, 2006 represented 86% and 85%, respectively, of total long-term loans. Loans converting from a variable rate to a fixed rate for the six months ended November 30, 2006 totaled \$181 million, which was offset by \$54 million of loans that converted from a fixed rate to a variable rate. This resulted in a net conversion of \$127 million from a variable rate to a fixed rate for the six months ended November 30, 2006. For the six months ended November 30, 2005, loans converting from a variable rate to a fixed rate totaled \$1,299 million, which was offset by \$4 million of loans that converted from a fixed rate to a variable rate. This resulted in a net conversion of \$1,295 million from a variable rate to a fixed rate for the six months ended November 30, 2005.

The following chart summarizes loans and guarantees outstanding by segment at:

(Dollar amounts in millions)	November 30, 2006		May 31, 2006		Increase/ (Decrease)
CFC:					
Distribution	\$12,951	67%	\$12,929	67%	\$ 22
Power supply	3,711	19%	3,733	19%	(22)
Statewide and associate	143	1%	158	1%	(15)
CFC Total	16,805	87%	16,820	87%	(15)
RTFC	2,017	10%	2,162	11%	(145)
NCSC	479	3%	458	2%	2
Total	\$19,301	100%	\$19,440	100%	\$ (139)

The following table summarizes the RTFC segment loans and guarantees outstanding:

(Dollar amounts in millions)	November 30, 2006		May 31, 2006		Increase/ (Decrease)
Rural local exchange carriers	\$ 1,721	85%	\$ 1,815	84%	\$ (94 )
Cable television providers	175	9%	179	8%	(4 )
Long distance carriers	50	3%	89	5%	(39 )
Fiber optic network providers	41	2%	41	2%	-
Competitive local exchange carriers	23	1%	28	1%	(5 )
Wireless providers	3	-	5	-	(2 )
Other	4	-	5	-	(1 )
Total	\$ 2,017	100%	\$ 2,162	100%	\$ (145 )

The Company's members are widely dispersed throughout the United States and its territories, including 49 states, the District of Columbia and two U.S. territories. At November 30, 2006 and May 31, 2006, loans outstanding to members in any one state or territory did not exceed 16% of total loans outstanding.

#### 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 set the limit on the total exposure and unsecured exposure to the borrower based on an assessment of the borrower's risk profile and the Company's internal risk rating system. As a member owned cooperative, the Company makes best efforts to balance meeting the needs of its member/owners and mitigating the risk associated with concentrations of credit exposure. The respective boards of directors must approve new credit requests from a borrower with a total exposure or unsecured exposure in excess of the limits in the policy. Management of credit concentrations may include the use of syndicated credit agreements.

The Company's credit limitation policy sets the limit on the total exposure and unsecured exposure to the borrower based on an assessment of the borrower's risk profile.

Total exposure, as defined by the policy, includes the following:

- \* loans outstanding, excluding loans guaranteed by RUS,
- \* the Company's guarantees of the borrower's obligations,
- \* unadvanced loan commitments, and
- \* borrower guarantees to the Company of another borrower's debt.

At November 30, 2006 and May 31, 2006, the total exposure outstanding to any one borrower or controlled group did not exceed 3% of total loans and guarantees outstanding. At November 30, 2006, the ten largest borrowers included five distribution systems, three power supply systems and two telecommunications system. At May 31, 2006, the ten largest borrowers included four distribution systems, five power supply systems and one telecommunications systems.

The following chart shows the exposure to the ten largest borrowers as a percentage of total exposure by type and by segment at:

November 30, 2006

May 31, 2006

(Dollar amounts in millions)	Amount	% of Total	Amount	% of Total
Total by type:				
Loans	\$ 3,258		\$ 3,140	
Guarantees	150		267	
Total credit exposure to ten largest borrowers	\$ 3,408	18%	\$ 3,407	18%
Total by segment:				
CFC	\$ 2,719		\$ 2,856	
RTFC	689		488	
NCSC	-		63	
Total credit exposure to ten largest borrowers	\$ 3,408	18%	\$ 3,407	18%

### Security Provisions

Except when providing lines of credit loans, the Company typically lends to its members on a senior secured basis. Long-term loans are typically secured on a parity with other secured lenders (primarily RUS), if any, by all assets and revenues of the borrower with exceptions typical in utility mortgages. Short-term loans are generally unsecured lines of credit. Guarantee reimbursement obligations are typically secured on parity with other secured creditors by all assets and revenues of the borrower or by the underlying financed asset. In addition to the collateral received, borrowers are also required to set rates designed to achieve certain financial ratios.

The following table summarizes the Company's unsecured credit exposure as a percentage of total exposure by type and by segment at:

(Dollar amounts in millions)	November 30, 2006		May 31, 2006	
	Amount	% of Total	Amount	% of Total
Total by type:				
Loans	\$ 1,565		\$ 1,554	
Guarantees	203		144	
Total unsecured credit exposure	\$ 1,768	9%	\$ 1,698	9%
Total by segment:				
CFC	\$ 1,428		\$ 1,358	
RTFC	252		241	
NCSC	88		99	
Total unsecured credit exposure	\$ 1,768	9%	\$ 1,698	9%

#### Non-performing Loans

A borrower is classified as non-performing when any one of the following criteria are 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, CFC typically places the loan on non-accrual status and reverses all accrued and unpaid interest back to the date of the last payment. The Company generally applies all cash received during the non-accrual period to the reduction of principal, thereby foregoing interest income recognition. At November 30, 2006 and May 31, 2006, the Company had non-performing loans outstanding in the amount of \$539 million and \$578 million, respectively. All loans classified as non-performing were on a non-accrual status with respect to the recognition of interest income.

At November 30, 2006 and May 31, 2006, non-performing loans include \$489 million and \$488 million, respectively, to Innovative Communication Corporation ("ICC"). All loans to ICC have been on non-accrual status since February 1, 2005. ICC has not made debt service payments to the Company since June 2005. RTFC is the primary secured lender to ICC.

As part of a settlement agreement, RTFC obtained entry of judgments against ICC for approximately \$525 million and ICC's indirect majority shareholder and chairman, Jeffrey Prosser ("Prosser") for approximately \$100 million. RTFC also obtained dismissals with prejudice of all counterclaims, affirmative defenses and other lawsuits alleging wrongful acts by RTFC, certain of its officers, and CFC. Various parties also reached agreement for ICC to satisfy the RTFC judgments in the third quarter of calendar year 2006, subject to certain terms and conditions, however, on July 31, 2006, certain of the parties obligated to satisfy the RTFC judgments under the agreement filed voluntary bankruptcy proceedings, as described below, in order to obtain additional time to satisfy the judgments.

On July 31, 2006, ICC's immediate parent, Emerging Communication, Inc. ("Emcom") and Emcom's parent, Innovative Communication Company LLC ("ICC-LLC") each filed a voluntary petition under Chapter 11 of the United States Bankruptcy Code in the United States District Court for the Virgin Islands, Division of St. Thomas and



St. John, Bankruptcy Division, and Prosser, individually, filed a voluntary petition under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Virgin Islands. Prosser's case has been transferred to the United States District Court for the Virgin Islands, Division of St. Thomas and St. John, Bankruptcy Division. Each of the debtors is obligated to RTFC, for certain obligations of ICC, including court judgments. On September 25, 2006, ICC-LLC, Emcom and Prosser jointly filed a motion in the voluntary bankruptcy proceedings seeking court authority to assume the agreement under which each is obligated to satisfy the RTFC judgments. The debtors filed the motion in order to request a ruling that they could satisfy the RTFC judgments at a discount. On November 7, 2006, the bankruptcy court denied the motion without prejudice to refiling, finding that assumption of the agreement was impossible under the debtors' then-proposed cure provisions. The debtors continue to seek a sale or refinancing of their assets in an effort to satisfy their debts to RTFC.

On November 22, 2006, ICC-LLC, Emcom and Prosser each filed motions requesting a order preserving their respective exclusive rights to file a plan of reorganization. The Court granted an extension of exclusivity through January 12, 2007.

On December 1, 2006, RTFC filed a motion to lift the automatic stay in bankruptcy in the Emcom case, seeking permission to enforce RTFC's security interest in the common stock of ICC in partial satisfaction of its judgments. An evidentiary hearing was held on January 9, 2007 and the Court deferred its ruling until completion of evidentiary hearings on other motions, scheduled for January 19, 2007.

On December 19, 2006, the United States Trustee filed a motion to appoint Chapter 11 trustees for the bankruptcy estates of ICC-LLC and Emerging, asserting that the appointment of a trustee was in the "best interest of the creditors and other interest holders." An evidentiary hearing on the motion has been scheduled for January 19, 2007.

Also on December 19, 2006, the Greenlight Entities filed a motion to convert Prosser's individual bankruptcy case from Chapter 11 reorganization to Chapter 7 liquidation, which would require appointment of a Chapter 7 trustee for the bankruptcy estate. On December 19, 2006, RTFC filed a motion to convert and joinder in support of the Greenlight Entities' motion to convert Prosser's individual case to Chapter 7. An evidentiary hearing was held on January 9, 2007 and the Court deferred its ruling until completion of evidentiary hearings on other motions, scheduled for January 19, 2007.

For a more detailed description of the contingencies related to the non-performing loans outstanding to ICC, see Note 12 to the consolidated financial statements. Based on its analysis, the Company believes that it is adequately reserved for its exposure to ICC at November 30, 2006.

Non-performing loans at November 30, 2006 and May 31, 2006 include a total of \$50 million and \$90 million, respectively, to VarTec Telecom, Inc. ("VarTec"). At November 30, 2006 and May 31, 2006, all loans to VarTec were on non-accrual status, resulting in the application of all payments received against principal.

Final proceeds from the closing of the Domestic Assets Sale were received in June 2006 totaling \$40 million. On June 19, 2006, the Chapter 11 proceedings were converted to Chapter 7 proceedings and a Chapter 7 trustee was appointed for each of the estates.

RTFC will continue to pursue collection of claims from the estate during the bankruptcy proceeding.

The adversary proceeding filed by the Official Committee of Unsecured Creditors (the "UCC"), identified payments made by VarTec to RTFC of approximately \$141 million, but does not specify damages sought. On November 14, 2006, the plaintiff supplemented its required disclosures and asserted alternative calculations of damages under its various legal theories, ranging from \$32 million to \$235 million. Trial, if necessary, on the merits of the remaining claims is currently scheduled for March 5, 2007. The trial date is subject to change.

At November 30, 2006, there was \$9 million outstanding from RTFC to VarTec on the court approved debtor-in-possession loan ("DIP"). RTFC may consider providing the estate with further DIP funding to pursue the collection of various claims.

For a more detailed description of the contingencies related to the non-performing loans outstanding to VarTec, see Note 12 to the consolidated financial statements. Based on its analysis, the Company believes that it is adequately reserved for its exposure to VarTec at November 30, 2006.

#### Restructured Loans

Loans classified as restructured are loans for which agreements have been executed that changed the original terms of the loan, generally a change to the originally scheduled cash flows. The Company will make a determination on each restructured loan with regard to the accrual of interest income on the loan. 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. The Company will periodically review the decision to accrue or not to accrue interest income on restructured loans based on the borrower's past performance and current financial condition.

At November 30, 2006 and May 31, 2006, restructured loans totaled \$616 million and \$630 million, respectively. A total of \$557 million and \$569 million of restructured loans were on non-accrual status with respect to the recognition of interest income at November 30, 2006 and May 31, 2006, respectively. At November 30, 2005, there were \$581 million of restructured loans on non-accrual status.

At November 30, 2006 and May 31, 2006, the Company had \$557 million and \$569 million, respectively, of loans outstanding to Denton County Electric Cooperative, Inc. d/b/a CoServ Electric ("CoServ"). All CoServ loans have been on non-accrual status since January 1, 2001. Total loans to CoServ at November 30, 2006 and May 31, 2006 represented 2.9% of the Company's total loans and guarantees outstanding. To date, CoServ has made all required payments under the restructured loan. Under the agreement, CoServ will be required to make quarterly payments to CFC through 2037.

For a more detailed description of the contingencies related to the loans outstanding to CoServ, see Note 12 to the consolidated financial statements. Based on its analysis, the Company believes that it is adequately reserved for its exposure to CoServ at November 30, 2006.

At November 30, 2006 and May 31, 2006, total restructured loans included a total of \$52 million and \$54 million, respectively in loans outstanding to Pioneer Electric Cooperative, Inc. ("Pioneer"). Pioneer was current with respect to all debt service payments at November 30, 2006. All loans to Pioneer remain on accrual status with respect to the recognition of interest income. CFC is the principal creditor to Pioneer.

For a more detailed description of the contingencies related to the loans outstanding to Pioneer, see Note 12 to the consolidated financial statements. Based on its analysis, the Company believes that it is adequately reserved for its exposure to Pioneer at November 30, 2006.

#### Loan Impairment

On a quarterly basis, the Company reviews all non-performing and restructured borrowers, as well as some additional borrowers, to determine if the loans to the borrower are impaired and/or to update the impairment calculation. The Company calculates an impairment for a borrower based on the expected future cash flow or the fair value of any collateral held by the Company as security for loans to the borrower. In some cases, to estimate future cash flow, certain assumptions are required regarding, but not limited to, the following:

- \* interest rates,
- \* court rulings,
- \* changes in collateral values,
- \* changes in economic conditions in the area in which the cooperative operates, and
- \* changes to the industry in which the cooperative operates.

As events related to the borrower take place and economic conditions and the Company's assumptions change, the impairment calculations will change. The loan loss allowance specifically reserved to cover the calculated impairments is adjusted on a quarterly basis based on the most current information available. At November 30, 2006 and May 31, 2006, CFC had impaired loans totaling \$1,148 million and \$1,201 million, respectively. At November 30, 2006 and May 31, 2006, CFC had specifically reserved a total of \$452 million and \$447 million, respectively, to cover impaired loans.

The following chart presents a summary of non-performing and restructured loans as a percentage of total loans and total loans and guarantees outstanding:

#### NON-PERFORMING AND RESTRUCTURED LOANS

(Dollar amounts in millions)	November 30, 2006	May 31, 2006
Non-performing loans	\$ 539	\$ 578
Percent of loans outstanding	2.97%	3.15%
Percent of loans and guarantees outstanding	2.79%	2.97%
Restructured loans	\$ 616	\$ 630
Percent of loans outstanding	3.39%	3.43%
Percent of loans and guarantees outstanding	3.19%	3.24%
Total non-performing and restructured loans	\$ 1,155	\$ 1,208
Percent of loans outstanding	6.36%	6.58%
Percent of loans and guarantees outstanding	5.98%	6.21%

#### Allowance for Loan Losses

The Company maintains an allowance for probable loan losses, which is reviewed quarterly by management for adequacy. The Company maintains an allowance for loan losses at a level estimated by management to provide adequately for probable losses inherent in the loan portfolio, which are estimated based upon a review of the loan portfolio, past loss experience, specific problem loans, economic conditions and other pertinent factors which, in management's judgment, deserve current recognition in estimating loan losses.

Management makes recommendations to the board of directors of CFC regarding write-offs of loan balances. In making its recommendation to write off all or a portion of a loan balance, management considers various factors including cash flow analysis and the collateral securing the borrower's loans. Since inception in 1969, write-offs totaled \$150 million and recoveries totaled \$33 million for a net loss amount of \$117 million. In the past five fiscal years and the first six months of fiscal year 2007, write-offs totaled \$51 million and recoveries totaled \$16 million for a net loan loss of \$35 million.

Management believes that the allowance for loan losses is adequate to cover estimated probable portfolio losses.

Activity in the allowance for loan losses is summarized below:

(Dollar amounts in millions)	For the six months ended and as of		For the year ended and as of
	November 30, 2006	November 30, 2005	May 31, 2006
Beginning balance	\$ 611	\$ 590	\$ 590
Provision for loan losses	-	4	23
Net (write-offs) recoveries	-	-	(2)
Ending balance	\$ 611	\$ 594	\$ 611
Loan loss allowance by segment:			
CFC	\$ 610	\$ 593	\$ 610
NCSC	1	1	1
Total	\$ 611	\$ 594	\$ 611
As a percentage of total loans outstanding	3.36%	3.27%	3.33%
As a percentage of total non-performing loans outstanding	113.36%	106.45%	105.71%
As a percentage of total restructured loans outstanding	99.19%	101.02%	96.98%

CFC has agreed to indemnify RTFC and NCSC for loan losses, with the exception of the NCSC consumer loans that are covered by the NCSC loan loss allowance. Therefore, there is no loan loss allowance required at RTFC and only a small loan loss allowance is required at NCSC to cover the exposure to consumer loans.

The Company's loan loss allowance at November 30, 2006 was consistent with the balance at May 31, 2006.

#### Liabilities, Minority Interest and Equity

##### Outstanding Debt

The following chart provides a breakout of debt outstanding:

(Dollar amounts in millions)	November 30, 2006	May 31, 2006	Increase/ (Decrease)
Short-term debt:			
Commercial paper (1)	\$ 3,391	\$ 3,255	\$ 136
Bank bid notes	100	100	-
Long-term debt with remaining maturities less than one year	1,473	1,594	(121)
Foreign currency valuation account	229	245	(16)
Subordinated deferrable debt with remaining maturities less than one year	-	150	(150)
Total short-term debt	5,193	5,344	(151)
Long-term debt:			

Collateral trust bonds	3,648	3,847	(199)
Notes payable	2,568	2,575	(7)
Medium-term notes	4,181	4,220	(39)
Total long-term debt	10,397	10,642	(245)
Subordinated deferrable debt	486	486	-
Members' subordinated certificates:			
Membership certificates	651	651	-
Loan certificates	651	641	10
Guarantee certificates	124	136	(12)
Total members' subordinated certificates	1,426	1,428	(2)
Total debt outstanding	\$ 17,502	\$ 17,900	\$ (398)
Percentage of fixed rate debt (2)	84%	83%	
Percentage of variable rate debt (3)	16%	17%	
Percentage of long-term debt	70%	70%	
Percentage of short-term debt	30%	30%	

(1) Includes \$245 million and \$267 million related to the daily liquidity fund at November 30, 2006 and May 31, 2006, respectively.

(2) Includes variable rate debt that has been swapped to a fixed rate less any fixed rate debt that has been swapped to a variable rate.

(3) The rate on commercial paper notes does not change once the note has been issued. However, the rates on new commercial paper notes change daily and commercial paper notes generally have maturities of less than 90 days. Therefore, commercial paper notes are considered to be variable rate debt. Also includes fixed rate debt that has been swapped to a variable rate less any variable rate debt that has been swapped to a fixed rate.

Total debt outstanding at November 30, 2006 decreased as compared to May 31, 2006 due primarily to decreases of \$203 million to loans outstanding and \$159 million to cash and cash equivalents. The decrease to loan volume reduces the amount of debt required to fund loans. During the six months ended November 30, 2006, CFC used cash to pay down short-term debt. Short-term debt decreased due to the redemption and maturity of long-term debt, offset by an increase in commercial paper at November 30, 2006. In June 2006, the Company redeemed the 7.625% subordinated deferrable debt securities due 2050 totaling \$150 million. The Company redeemed these securities at par and recorded a charge of \$5 million in interest expense for the unamortized issuance costs.

In December 2006, the Company issued \$600 million of floating rate extendible collateral trust bonds. The bonds mature in 2008 unless extended by the holders, but no later than 2012.

At November 30, 2006 and May 31, 2006, the Company had a total of \$662 million and \$960 million, respectively, of foreign denominated debt. As a result of issuing debt in foreign currencies, the Company must adjust the value of the debt reported on the consolidated balance sheets for changes in foreign currency exchange rates since the date of issuance. To the extent that the current exchange rate is different than the exchange rate at the time of issuance, there will be a change in the value of the foreign denominated debt. The adjustment to the value of the debt for the current period is reported on the consolidated statements of operations as foreign currency adjustments. At the time of issuance of all foreign denominated debt, the Company enters into a cross currency or cross currency interest rate exchange agreement to fix the exchange rate on all principal and interest payments through maturity. At November 30, 2006 and May 31, 2006, the reported amount of foreign denominated debt includes a valuation adjustment of \$229 million and \$245 million, respectively due to changes in the value of the Euro and Australian dollar versus the U.S. dollar since the time the debt was issued.

#### Minority Interest

Minority interest on the consolidated balance sheets at November 30, 2006 and May 31, 2006 was \$21 million and \$22 million, respectively. During the six months ended November 30, 2006, the balance of minority interest decreased by \$1 million of minority interest net loss.

#### Equity

The following chart provides a breakout of the equity balances:

(in millions)	November 30, 2006	May 31, 2006	Increase/ (Decrease)
Membership fees	\$ 1	\$ 1	\$ -
Education fund	1	1	-
Members' capital reserve	157	157	-
Allocated net income	302	386	(84)
Unallocated income	31	-	31
Total members' equity	492	545	(53)
Prior years cumulative derivative forward value and foreign currency adjustments	230	229	1
Current period derivative forward value (1)	(107)	23	(130)
Current period foreign currency adjustments	(17)	(22)	5
Total retained equity	598	775	(177)
Accumulated other comprehensive income	13	13	-
Total equity	\$ 611	\$ 788	\$ (177)



(1) Represents the derivative forward value (loss) gain recorded by CFC for the period.

Applicants are required to pay a one-time fee to become a member. The fee varies from two hundred dollars to one thousand dollars depending on the membership class. CFC is required by the District of Columbia cooperative law to have a methodology to allocate its net earnings to its members. CFC maintains the current year net earnings as unallocated through the end of its fiscal year. At that time, CFC's board of directors allocates its net earnings to its members in the form of patronage capital and to board approved reserves. Currently, CFC has two such board approved reserves, the education fund and the members' capital reserve. CFC adjusts the net earnings it allocates to its members and board approved reserves to exclude the non-cash impacts of SFAS 133 and 52. CFC allocates a small portion, less than 1%, of adjusted net earnings annually to the education fund as required by cooperative law. Funds from the education fund are disbursed annually to the statewide cooperative organizations to fund the teaching of cooperative principles in the service territories of the cooperatives in each state. The board of directors determines the amount of adjusted net earnings that is allocated to the members' capital reserve, if any. The members' capital reserve represents earnings that are held by CFC to increase equity retention. The earnings held in the members' capital reserve have not been specifically allocated to any member, but may be allocated to individual members in the future as patronage capital if authorized by CFC's board of directors. All remaining adjusted net earnings is allocated to CFC's members in the form

of patronage capital. CFC bases the amount of adjusted net earnings allocated to each member on the members' patronage of the CFC lending programs in the year that the adjusted net earnings was earned. There is no impact on CFC's total equity as a result of allocating earnings to members in the form of patronage capital or to board approved reserves. CFC annually retires a portion of the patronage capital allocated to members in prior years. CFC's total equity is reduced by the amount of patronage capital retired to its members and by amounts disbursed from board approved reserves.

At November 30, 2006, equity decreased \$177 million from May 31, 2006 due to the retirement of \$84 million of CFC patronage capital to its members and the net loss of \$92 million for the six months ended November 30, 2006.

#### Contractual Obligations

The following table summarizes the long-term contractual obligations at November 30, 2006 and the scheduled reductions by fiscal year.

(in millions)	2007	2008	2009	2010	2011	More than 5 Years	Total
Instrument							
Long-term debt due in less than one year	\$ 1,359	\$ 343	\$ -	\$ -	\$ -	\$ -	\$ 1,702
Long-term debt	-	1,856	1,041	1,494	520	5,486	10,397
Subordinated deferrable debt	-	-	-	-	-	486	486
Members' subordinated certificates (1)	5	11	19	5	18	1,059	1,117
Operating leases (2)	2	3	1	-	-	-	6
Contractual interest on long-term debt (3)	342	619	526	449	409	4,740	7,085
Total contractual obligations	\$ 1,708	\$ 2,832	\$ 1,587	\$ 1,948	\$ 947	\$ 11,771	\$ 20,793

(1) Excludes loan subordinated certificates totaling \$309 million that amortize annually based on the outstanding balance of the related loan. There are many items that impact the amortization of a loan, such as loan conversions, loan repricing at the end of an interest rate term, prepayments, etc, thus an amortization schedule cannot be maintained for these certificates. Over the past three years, annual amortization on these certificates has averaged \$27 million. In fiscal year 2006, amortization represented 8% of amortizing loan subordinated certificates outstanding.

(2) Represents the payment obligation related to the Company's three-year lease of office space for its headquarters facility.

(3) Represents the interest obligation on the Company's debt based on terms and conditions at November 30, 2006.

#### Off-Balance Sheet Obligations

##### Guarantees

The following chart provides a breakout of guarantees outstanding by type and by segment:

(in millions)	November 30, 2006	May 31, 2006	Increase/ (Decrease)
Total by type:			
Long-term tax-exempt bonds	\$ 588	\$ 608	\$ (20)

Indemnifications of tax benefit transfers	117	124	(7)
Letters of credit	364	272	92
Other guarantees	74	75	(1)
Total	\$ 1,143	\$1,079	\$ 64
Total by segment:			
CFC	\$ 1,066	\$ 1,025	\$ 41
NCSC	77	54	23
Total	\$ 1,143	\$ 1,079	\$ 64

The increase in total guarantees outstanding at November 30, 2006 compared to May 31, 2006 is due to the \$78 million increase to letters of credit to distribution systems and the \$23 million increase to letters of credit to NCSC borrowers offset by normal amortization on long-term tax-exempt bonds and tax benefit transfers.

At November 30, 2006 and May 31, 2006, the Company had recorded a guarantee liability totaling \$19 million and \$17 million, respectively, which represents the contingent and non-contingent exposure related to guarantees of members' debt obligations.

The following table summarizes the off-balance sheet obligations at November 30, 2006 and the related principal amortization and maturities by fiscal year.

(in millions)	Principal Amortization and Maturities						Remaining Years
	Outstanding Balance	2007	2008	2009	2010	2011	
Guarantees (1)	\$1,143	\$120	\$157	\$93	\$165	\$156	\$452

(1) On a total of \$556 million of tax-exempt bonds, CFC has unconditionally agreed to purchase bonds tendered or put for redemption at any time if the remarketing agents have not sold such bonds to other purchasers.

### Contingent Off-Balance Sheet Obligations

#### Unadvanced Loan Commitments

At November 30, 2006, the Company had unadvanced loan commitments totaling \$13,091 million, an increase of \$311 million compared to the balance of \$12,780 million at May 31, 2006. Unadvanced commitments are loans for which loan contracts have been approved and executed, but funds have not been advanced. The majority of the short-term unadvanced commitments provide backup liquidity to the Company's borrowers; therefore, it does not anticipate funding most of these commitments. Approximately 52% of the outstanding commitments at November 30, 2006 and May 31, 2006 were for short-term or line of credit loans. Substantially all above mentioned credit commitments contain material adverse change clauses, thus for a borrower to qualify for the advance of funds, the Company must be satisfied that there has been no material change since the loan was approved.

Unadvanced loan commitments do not represent off-balance sheet liabilities and have not been included in the chart summarizing off-balance sheet obligations above. The Company has no obligation to advance amounts to a borrower that does not meet the minimum conditions as determined by CFC's credit underwriting policy in effect at the time the loan was approved. If there has been a material adverse change in the borrower's financial condition or the borrower has not satisfied other terms in the agreement, the Company is not required to advance funds. Therefore, unadvanced commitments are classified as contingent liabilities.

### Ratio Analysis

#### Leverage Ratio

The leverage ratio is calculated by dividing the sum of total liabilities and guarantees outstanding by total equity. Based on this formula, the leverage ratio at November 30, 2006 was 31.36, an increase from 24.68 at May 31, 2006. The increase in the leverage ratio is due to a decrease of \$177 million in total equity and an increase of \$64 million in guarantees offset by a decrease of \$363 million to total liabilities as discussed under the Liabilities, Minority Interest and Equity section and the Off-Balance Sheet Obligations section of "Financial Condition".

For the purpose of covenant compliance on its revolving credit agreements and for internal management purposes, the leverage ratio calculation is adjusted to exclude derivative liabilities, debt used to fund RUS guaranteed loans, the foreign currency valuation account, subordinated deferrable debt and subordinated certificates from liabilities, uses members' equity rather than total equity and adds subordinated deferrable debt, subordinated certificates and minority interest to arrive at adjusted equity. At November 30, 2006 and May 31, 2006, the adjusted leverage ratio was 6.86 and 6.38, respectively. See "Non-GAAP Financial Measures" for further explanation and a reconciliation of the adjustments the Company makes in its leverage ratio calculation.

The increase in the adjusted leverage ratio is due to a decrease in adjusted equity of \$206 million and an increase of \$64 million in guarantees offset by a decrease of \$208 million in adjusted liabilities. See "Non-GAAP Financial Measures" for further explanation and a reconciliation of the adjustments the Company makes in its leverage ratio calculation.

In addition to the adjustments made to the leverage ratio in the "Non-GAAP Financial Measures" section, guarantees to member systems that have an investment grade rating from Moody's Investors Service and Standard & Poor's Corporation are excluded from the calculation of the leverage ratio under the terms of the revolving credit agreements.

#### Debt to Equity Ratio

The debt to equity ratio is calculated by dividing the sum of total liabilities outstanding by total equity. The debt to equity ratio, based on this formula at November 30, 2006 was 29.49, an increase from 23.31 at May 31, 2006. The increase in the debt to equity ratio is due to the decrease of \$177 million to total equity offset by the decrease of \$363 million to total liabilities as discussed under the Liabilities, Minority Interest and Equity section of "Financial Condition".

For internal management purposes, the debt to equity ratio calculation is adjusted to exclude derivative liabilities, debt used to fund RUS guaranteed loans, the foreign currency valuation account, subordinated deferrable debt and subordinated certificates

from liabilities, uses members' equity rather than total equity and adds subordinated deferrable debt, subordinated certificates and minority interest to arrive at adjusted equity. At November 30, 2006 and May 31, 2006, the adjusted debt to equity ratio was 6.39 and 5.97, respectively. See "Non-GAAP Financial Measures" for further explanation and a reconciliation of the adjustments made to the debt to equity ratio calculation.

#### Credit Ratings

The Company's long- and short-term debt and guarantees are rated by three of the major credit rating agencies, Moody's Investors Service, Standard & Poor's Corporation and Fitch Ratings. The following table presents the Company's credit ratings at November 30, 2006.

	Moody's Investors Service	Standard & Poor's Corporation	Fitch Ratings
Direct:			
Senior secured debt	A1	A+	A+
Senior unsecured debt	A2	A	A
Subordinated deferrable debt	A3	BBB+	A-
Commercial paper	P-1	A-1	F-1
Guarantees:			
Leveraged lease debt	A2	A	A
Pooled bonds	A1	A	A
Other bonds	A2	A	A
Short-term	P-1	A-1	F-1

The ratings listed above have the meaning as defined by each of the respective rating agencies, are not recommendations to buy, sell or hold securities and are subject to revision or withdrawal at any time by the rating organizations.

Standard & Poor's Corporation, Moody's Investors Service, and Fitch Ratings have the Company's ratings on stable outlook.

#### Liquidity and Capital Resources

The following section will discuss the Company's sources and uses of liquidity. The Company's primary sources of liquidity include capital market debt issuance, private debt issuance, member loan principal repayments, member loan interest payments, a revolving bank line facility and member investments. The Company's primary uses of liquidity include loan advances, interest payments on debt, principal repayments on debt and patronage capital retirements. The Company feels that its sources of liquidity are adequate to cover the uses of liquidity.

#### Sources of Liquidity

##### Capital Market Debt Issuance

At November 30, 2006, the Company had effective registration statements covering \$1,075 million of collateral trust bonds, \$3,836 million of medium-term notes and \$165 million of subordinated deferrable debt. The Company has Board authorization to issue up to \$1 billion of commercial paper and \$4 billion of medium-term notes in the European market of which \$1 billion and \$3.6 billion, respectively, was remaining at November 30, 2006. The Company has Board authorization to issue \$1.6 billion of medium-term notes in the Australian market of which \$1.6 billion was remaining at November 30, 2006. In addition, the Company has a commercial paper program under which it sells commercial paper to investors in the capital markets. The amount of commercial paper that can be sold is limited to the amount of backup liquidity available under the Company's revolving credit agreement.

#### Private Debt Issuance

The Company made use of two sources of private debt issuance during fiscal year 2006. In July 2005, the Company issued \$500 million of notes to Farmer Mac due in 2008 and secured such issuance with the pledge of loans to distribution systems as collateral. The Company is also authorized to borrow up to \$2.5 billion under FFB loan facilities with bond guarantee agreements with RUS as part of the funding mechanism for the REDLG program. At November 30, 2006, the Company had a total of \$2 billion of funding outstanding as part of the REDLG program.

#### Member Loan Repayments

Scheduled repayments on long-term loans are expected to average \$807 million a year for fiscal years 2007 to 2011. There has been significant prepayment activity over the past two fiscal years in the telecommunications loan programs. It is not anticipated that there will be significant loan prepayments over the next few years.

#### Member Loan Interest Payments

During the six months ended November 30, 2006, interest income on the loan portfolio was \$510 million, representing an average yield of 5.56% as compared to 5.14% for the six months ended November 30, 2005. At November 30, 2006, 81% of the

total loans outstanding had a fixed rate of interest and 19% of loans outstanding had a variable rate of interest. At November 30, 2006, a total of 6% of loans outstanding were on a non-accrual basis with respect to the recognition of interest income.

#### Bank Revolving Credit Facility

The following is a summary of the Company's revolving credit agreements:

(Dollar amounts in millions)	November 30, 2006	May 31, 2006	Termination Date	Facility fee per annum (1)
364-day agreement (2)	\$ 1,025	\$ 1,025	March 21, 2007	0.05 of 1%
Five-year agreement	1,025	1,025	March 22, 2011	0.06 of 1%
Five-year agreement	1,975	1,975	March 23, 2010	0.09 of 1%
Total	\$ 4,025	\$ 4,025		

(1) Facility fee determined by CFC's senior unsecured credit ratings based on the pricing schedules put in place at the initiation of the related agreement.

(2) Any amount outstanding under these agreements may be converted to a one-year term loan at the end of the revolving credit periods. If converted to a term loan, the fee on the outstanding principal amount of the term loan is 0.10 of 1% per annum.

Up-front fees of between 0.05 and 0.13 of 1% were paid to the banks based on their commitment level to the five-year agreements in place at November 30, 2006, totaling in aggregate \$3 million, which will be amortized on a straight-line basis over the life of the agreements. No upfront fees were paid to the banks for their commitment to the 364-day facility. Each agreement contains a provision under which if borrowings exceed 50% of total commitments, a utilization fee must be paid on the outstanding balance. The utilization fees are 0.05 of 1% for the five-year agreement terminating on March 22, 2011 and the 364-day agreement terminating on March 21, 2007 and 0.10 of 1% for the five-year agreement terminating on March 23, 2010 outstanding at November 30, 2006.

Effective November 30, 2006 and May 31, 2006, the Company was in compliance with all covenants and conditions under its revolving credit agreements in place at that time and there were no borrowings outstanding under such agreements.

For the purpose of calculating the required financial covenants contained in its revolving credit agreements, the Company adjusts net income, senior debt and total equity to exclude the non-cash adjustments related to SFAS 133 and 52. The adjusted TIER, as defined by the agreements, represents the interest expense adjusted to include the derivative cash settlements, plus minority interest net income, plus net income prior to the cumulative effect of change in accounting principle and dividing that total by the interest expense adjusted to include the derivative cash settlements. In addition to the non-cash adjustments related to SFAS 133 and 52, senior debt also excludes RUS guaranteed loans, subordinated deferrable debt, members' subordinated certificates and minority interest. Total equity is adjusted to include subordinated deferrable debt, members' subordinated certificates and minority interest. Senior debt includes guarantees; however, it excludes:



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

The following represents the Company's required and actual financial ratios under the revolving credit agreements at or for the six months ended November 30, 2006 and at or for the year ended May 31, 2006:

	Requirement	November 30, 2006	May 31, 2006
Minimum average adjusted TIER over the six most recent fiscal quarters	1.025	1.10	1.11
Minimum adjusted TIER at fiscal year end (1)	1.05	1.11	1.11
Maximum ratio of senior debt to total equity	10.00	6.75	6.26

(1) The Company must meet this requirement in order to retire patronage capital.

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

## Member Investments

At November 30, 2006 and May 31, 2006 members funded 20.3% and 19.2%, respectively, of total assets as follows:

(Dollar amounts in millions)	November 30, 2006		May 31, 2006		Increase/ Decrease
	Amount	% of Total (1)	Amount	% of Total (1)	
Commercial paper (2)	\$ 1,624	48%	\$ 1,451	45%	\$ 173
Medium-term notes	249	4%	255	4%	(6)
Members' subordinated certificates	1,426	100%	1,428	100%	(2)
Members' equity (3)	492	100%	545	100%	(53)
Total	\$ 3,791		\$ 3,679		\$ 112
Percentage of total assets	20.3%		19.2 %		
Percentage of total assets less derivative assets (3)	20.8%		19.8 %		

(1) Represents the percentage of each line item outstanding to CFC members.

(2) Includes \$245 million and \$267 million related to the daily liquidity fund at November 30, 2006 and May 31, 2006, respectively.

(3) See "Non-GAAP Financial Measures" for further explanation and a reconciliation of the adjustments made to total capitalization and a breakout of members' equity.

## Uses of Liquidity

## Loan Advances

Loan advances arise from new loans approved to members and from the unadvanced portion of loans that were approved prior to November 30, 2006. At November 30, 2006, the Company had unadvanced loan commitments totaling \$13,091 million. The Company does not expect to advance the full amount of the unadvanced commitments at November 30, 2006. Unadvanced commitments generally expire within five years of the first advance on a loan and the majority of short-term unadvanced commitments are used as backup liquidity for member operations. Approximately 52% of the outstanding commitments at November 30, 2006 were for short-term or line of credit loans. The Company anticipates that over the next twelve months, loan advances will be approximately equal to the scheduled loan repayments.

## Interest Expense on Debt

For the six months ended November 30, 2006, interest expense on debt was \$479 million, representing 5.22% of the average loan volume for which the debt was used as funding. The interest expense on debt represented 4.99% of the average loan volume for which the debt was used as funding for the six months ended November 30, 2005. At November 30, 2006, a total of 84% of outstanding debt had a fixed interest rate and 16% of outstanding debt had a variable interest rate.

## Principal Repayments on Long-term Debt

The principal amount of medium-term notes, collateral trust bonds, long-term notes payable, subordinated deferrable debt and membership subordinated certificates maturing in each of the five fiscal years following November 30, 2006 and thereafter is as follows:

(Dollar amounts in millions)	Amount Maturing (1)
2007	\$ 1,364
2008	2,210
2009	1,060
2010	1,499
2011	538
Thereafter	7,031
Total	\$ 13,702

- (1) Excludes loan subordinated certificates totaling \$309 million that amortize annually based on the outstanding balance of the related loan. There are many items that impact the amortization of a loan, such as loan conversions, loan repricing at the end of an interest rate term, prepayments, etc, thus an amortization schedule cannot be maintained for these certificates. Over the past three years, annual amortization on these certificates has averaged \$27 million. In fiscal year 2006, amortization represented 8% of amortizing loan subordinated certificates outstanding.

#### Patronage Capital Retirements

The Company has made retirements of its allocated patronage capital in 26 of the last 27 years. In July 2006, the CFC board of directors approved the allocation of a total of \$102 million from fiscal year 2006 net earnings and the members' capital reserve to the CFC members. In August and September 2006, CFC retired \$84 million of patronage capital to its members as retirement of 70% of the amount allocated for fiscal year 2006 and 1/9th of the amount allocated for fiscal years 1991, 1992 and 1993.

## Market Risk

The Company's primary market risks are interest rate risk and liquidity risk. The Company is also exposed to counterparty risk as a result of entering into interest rate, cross currency and cross currency interest rate exchange agreements.

## Interest Rate Risk

The Company's primary interest rate risk exposure is related to the funding of the fixed rate loan portfolio. The Company does not match fund the majority of its fixed rate loans with a specific debt issuance at the time the loan is advanced. The Company aggregates fixed rate loans until the volume reaches a level that will allow an economically efficient issuance of debt. The Company uses fixed rate collateral trust bonds, medium-term notes, subordinated deferrable debt, members' subordinated certificates, members' equity and variable rate debt to fund fixed rate loans. The Company allows borrowers flexibility in the selection of the period for which a fixed interest rate will be in effect. Long-term loans typically have 15 to 35 year maturities. Borrowers may select fixed interest rates for periods of one year through the life of the loan. The Company mitigates interest rate risk through the use of derivatives and a funding policy that matches fixed rate assets repricing or maturing by year to fixed rate liabilities and members' equity maturing by year. The interest rate risk is deemed minimal on variable rate loans, since the loans may be repriced either monthly or semi-monthly to reflect the cost of the debt used to fund the loans. At November 30, 2006 and May 31, 2006, 19% and 20%, respectively of loans carried variable interest rates.

## Matched Funding Policy

To monitor interest rate risk in the funding of fixed rate loans, the Company performs a monthly gap analysis (see chart on page 55). It is the Company's funding objective to manage the matched funding of asset and liability repricing terms within a range of 3% of total assets excluding derivative assets. At November 30, 2006, the Company had \$14,531 million of fixed rate assets amortizing or repricing, funded by \$12,736 million of fixed rate liabilities maturing during the next 30 years and \$1,918 million of members' equity and members' subordinated certificates, a portion of which does not have a scheduled maturity. The difference of \$123 million, or 0.66% of total assets and 0.68% of total assets excluding derivative assets, represents the fixed rate debt and equity maturing during the next 30 years in excess of the fixed rate assets. Fixed rate loans are funded with fixed rate collateral trust bonds, medium-term notes, long-term notes payable, subordinated deferrable debt, members' subordinated certificates and members' equity. With the exception of members' subordinated certificates, which are generally issued at rates below the Company's long-term cost of funding and with extended maturities, and commercial paper, the Company's liabilities have average maturities that closely match the repricing terms (but not the maturities) of its fixed interest rate loans. The Company also uses commercial paper supported by interest rate exchange agreements to fund its portfolio of fixed rate loans. Variable rate assets which reprice monthly are funded with short-term liabilities, primarily commercial paper, collateral trust bonds, long-term notes payable and medium-term notes issued with a fixed rate and swapped to a variable rate, medium-term notes issued at a variable rate, subordinated certificates, members' equity and bank bid notes. The interest rate associated with the assets and debt maturing or members' equity and members' certificates is used to calculate an adjusted TIER for each year and for the portfolio as a whole. The schedule allows the Company to analyze the impact on the overall adjusted TIER of issuing a certain amount of debt at a fixed rate for various maturities, prior to issuance of the debt. See "Non-GAAP Financial Measures" for further explanation and a reconciliation of the adjustments to TIER.

Certain of the Company's collateral trust bonds, subordinated deferrable debt and medium-term notes were issued with early redemption provisions. To the extent borrowers are allowed to convert their fixed rate loans to a variable interest rate and to the extent it is beneficial, the Company takes advantage of these early redemption provisions. However, because conversions and prepayments can take place at different intervals from early redemptions, the Company charges conversion fees designed to compensate for any additional interest rate risk it assumes.



The following chart shows the scheduled amortization and repricing of fixed rate assets and liabilities outstanding at November 30, 2006.

**INTEREST RATE GAP ANALYSIS**  
(Fixed Rate Assets/Liabilities)  
As of November 30, 2006

(Dollar amounts in millions)	1 year or less	Over 1 year but 3 years or less	Over 3 years but 5 years or less	Over 5 years but 10 years or less	Over 10 years but 20 years or less	Over 20 years	Total
<b>Assets:</b>							
Amortization and repricing	\$ 1,364	\$ 3,210	\$ 2,455	\$ 3,860	\$ 2,593	\$ 1,049	\$ 14,531
Total assets	\$ 1,364	\$ 3,210	\$ 2,455	\$ 3,860	\$ 2,593	\$ 1,049	\$ 14,531
<b>Liabilities and members' equity:</b>							
Long-term debt	\$ 1,800	\$ 2,889	\$ 2,630	\$ 4,010	\$ 1,053	\$ 354	\$ 12,736
Subordinated certificates	17	76	56	105	726	315	1,295
Members' equity (1)	-	28	25	113	77	380	623
Total liabilities and members' equity	\$ 1,817	\$ 2,993	\$ 2,711	\$ 4,228	\$ 1,856	\$ 1,049	\$ 14,654
Gap	\$ (453)	\$ 217	\$ (256)	\$ (368)	\$ 737	\$ -	\$ (123)
<b>(2)</b>							
Cumulative gap	\$ (453)	\$ (236)	\$ (492)	\$ (860)	\$ (123)	\$ (123)	
Cumulative gap as a % of total assets	(2.43)%	(1.27)%	(2.64)%	(4.61)%	(0.66)%	(0.66)%	
Cumulative gap as a % of adjusted total assets (3)	(2.49)%	(1.30)%	(2.71)%	(4.73)%	(0.68)%	(0.68)%	

- (1) Includes the portion of the loan loss allowance and subordinated deferrable debt allocated to fund fixed rate assets. See "Non-GAAP Financial Measures" for further explanation of why CFC uses members' equity in its analysis of the funding of its loan portfolio.
- (2) Assets less liabilities and members' equity.
- (3) Adjusted total assets represents total assets in the consolidated balance sheets less derivative assets.

#### Use of Derivatives

At November 30, 2006 and May 31, 2006, the Company was a party to interest rate exchange agreements with a total notional amount of \$12,564 million and \$12,536 million, respectively. The Company uses interest rate exchange agreements as part of its overall interest rate matching strategy. Interest rate exchange agreements are used when they provide a lower cost of funding or minimize interest rate risk. The Company will enter into interest rate exchange agreements only with highly rated financial institutions. CFC was using interest rate exchange agreements to synthetically change the interest rate from a variable rate to a fixed rate on \$7,378 million as of November 30, 2006 and \$7,350 million as of May 31, 2006 of debt used to fund long-term fixed rate loans. Interest rate exchange agreements were used to synthetically change the interest rates from fixed to variable on \$5,186 million of long-term debt as of November 30, 2006 and May 31, 2006. The Company has not invested in derivative financial instruments

for trading purposes in the past and does not anticipate doing so in the future.

Subsequent to the end of the quarter, in December 2006, the Company unwound two \$500 million pay variable and receive fixed interest rate exchange agreements. The Company unwound these interest rate exchange agreements in an effort to reduce the total number of swap positions and total notional size of the swap portfolio, reduce the number of swaps using the 30-day composite commercial paper index floating leg and reduce the number of offsetting positions in the swap portfolio. At November 30, 2006, CFC had recorded an asset of \$32 million representing the fair value of the \$1 billion of interest rate exchange agreements that were terminated in December 2006. As a result of the termination of these agreements, CFC will receive a payment from the counterparties representing their fair value on the date of termination. As a result of the termination, CFC will also reverse the previously recorded derivative asset. The cash payment will be recorded as an increase to cash settlements and the reversal of the derivative asset will be a reduction to the derivative forward value resulting in no significant impact on net income for the period.

As of November 30, 2006 and May 31, 2006, the Company was a party to cross currency and cross currency interest rate exchange agreements with a total notional amount of \$434 million and \$716 million, respectively, related to medium-term notes denominated in foreign currencies. Cross currency and cross currency interest rate exchange agreements with a total notional amount of \$434 million at November 30, 2006 and May 31, 2006 in which the Company receives Euros and pays U.S. dollars, and \$282 million at May 31, 2006 in which the Company receives Australian dollars and pays U.S. dollars, are used to synthetically change the foreign denominated debt to U.S. dollar denominated debt. In addition, all cross currency interest rate exchange agreements outstanding at November 30, 2006 and May 31, 2006 synthetically change the interest rate from the fixed rate on the foreign denominated debt to variable rate U.S. denominated debt or from a variable rate on the foreign denominated debt to a U.S. denominated variable rate.

The Company enters into an exchange agreement to sell the amount of foreign currency received from the investor for U.S. dollars on the issuance date and to buy the amount of foreign currency required to repay the investor principal and interest due through or on the maturity date. By locking in the exchange rates at the time of issuance, the Company has eliminated the possibility of any currency gain or loss (except in the case of the Company or a counterparty default or unwind of the transaction) which might otherwise have been produced by the foreign currency borrowing.

#### Counterparty Risk

The Company is exposed to counterparty risk related to the performance of the parties with which it has entered into interest rate, cross currency and cross currency interest rate exchange agreements. To mitigate this risk, the Company only enters into these agreements with financial institutions with investment grade ratings. To date, the Company has not experienced a failure of a counterparty to perform as required under any of these agreements. At the time counterparties are selected to participate in the exchange agreements, the counterparty must be a participant in one of the Company's revolving credit agreements. At November 30, 2006, the Company's interest rate, cross currency and cross currency interest rate exchange agreement counterparties had credit ratings ranging from AAA to A- as assigned by Standard & Poor's Corporation. See "Use of Derivatives" for the total notional amount of exchange agreements outstanding at November 30, 2006.

#### Foreign Currency Risk

The Company may issue commercial paper, medium-term notes or bonds denominated in foreign currencies. At November 30, 2006 and May 31, 2006, the Company had a total of \$434 million of medium-term notes denominated in Euros. At May 31, 2006, CFC had \$282 million of medium-term notes denominated in Australian dollars. The Company's foreign currency valuation account, which represents the change in the foreign exchange rate from the date of issuance to the reporting date, increased the debt balance by \$229 million and \$245 million at November 30, 2006 and May 31, 2006, respectively. The change in the value of the foreign denominated debt is reported in the consolidated statements of operations as foreign currency adjustments. See "Use of Derivatives" for actions the Company takes to mitigate foreign currency risk.

#### Rating Triggers

The Company has certain interest rate, cross currency, and cross currency interest rate exchange agreements that contain a condition that will allow one counterparty to terminate the agreement if the credit rating of the other counterparty drops to a certain level. This condition is commonly called a rating trigger. Under the rating trigger, 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 of the underlying derivative instrument. Rating triggers are not separate financial instruments and are not separate derivatives under SFAS 133. The Company's rating triggers are based on its senior unsecured credit rating from Standard & Poor's Corporation and Moody's Investors Service. At November 30, 2006, there are rating triggers associated with \$9,900 million notional amount of interest rate, cross currency and cross currency interest rate exchange agreements. If the Company's rating from Moody's Investors Service falls to Baa1 or the Company's rating from Standard & Poor's Corporation falls to BBB+, the counterparties may terminate agreements with a total notional amount of \$1,123 million. If the Company's rating from Moody's Investors Service falls below Baa1 or the Company's rating from Standard & Poor's Corporation falls below BBB+, the counterparties may terminate the agreements on the remaining total notional amount of \$8,777 million.

At November 30, 2006, the Company's exchange agreements subject to rating triggers had a derivative fair value of \$27 million, comprised of \$33 million that would be due to the Company and \$6 million that the Company would have to pay if all interest rate, cross currency and cross currency interest rate exchange agreements with a rating trigger at the level of BBB+ or Baa1 and above were to be terminated, and a derivative fair value of \$188 million, comprised of \$254 million that would be due to the Company and \$66 million that the Company would have to pay if



all interest rate, cross currency and cross currency interest rate exchange agreements with a rating trigger below the level of BBB+ or Baa1 were to be terminated. See chart on page 51 for CFC's senior unsecured credit ratings as of November 30, 2006.

#### Liquidity Risk

The Company faces liquidity risk in the funding of its loan portfolio. The Company offers long-term loans with maturities of up to 35 years and line of credit loans that are generally required to be paid down annually. On long-term loans, the Company offers a variety of interest rate options including the ability to fix the interest rate for terms of one year through maturity. At November 30, 2006, the Company has a total of \$1,702 million of long-term debt maturing during the next twelve months. The Company funds the loan portfolio with a variety of debt instruments and its members' equity. The Company typically does not match fund each of its loans with a debt instrument of similar final maturity. Debt instruments such as subordinated certificates have maturities that vary from the term of the associated loan or guarantee to 100 years and subordinated deferrable debt has been issued with maturities of up to 49 years. The Company may issue collateral trust bonds and medium-term notes for periods of up to 30 years, but typically issues such debt instruments with maturities of 2, 3, 5, 7 and 10 years. Debt instruments such as commercial paper and bank bid notes typically have maturities of 90 days or less. Therefore, the Company is at risk if it is not able to issue new debt

instruments to replace debt that matures prior to the maturity of the loans for which they are used as funding. Factors that mitigate liquidity risk include the Company maintenance of back-up liquidity through revolving credit agreements with domestic and foreign banks and a large volume of scheduled principal repayments received on an annual basis. At November 30, 2006 and May 31, 2006, the Company had a total of \$4,025 million in revolving credit agreements and bank lines of credit. In addition, the Company limits the amount of dealer commercial paper and bank bid notes used in the funding of loans. The Company's objective is to maintain the amount of dealer commercial paper and bank bid notes used to 15% or less of total debt outstanding. At November 30, 2006 and May 31, 2006, there was a total of \$1,725 million and \$1,758 million, respectively, of dealer commercial paper and bank bid notes outstanding, representing 10% of the Company's total debt outstanding.

For additional information of risks related to the Company's business, see Item 1A "Risk Factors".

#### Non-GAAP Financial Measures

The Company makes certain adjustments to financial measures in assessing its financial performance that are not in accordance with GAAP. These non-GAAP adjustments fall primarily into two categories: (1) adjustments related to the calculation of the TIER ratio, and (2) adjustments related to the calculation of leverage and debt to equity ratios. These adjustments reflect management's perspective on the Company's operations, and in several cases adjustments used to measure covenant compliance under its revolving credit agreements, and thus the Company believes these are useful financial measures for investors. The Company refers to its non-GAAP financial measures as "adjusted" throughout this document.

#### Adjustments to Net Income and the Calculation of the TIER Ratio

The following chart provides a reconciliation between interest expense, net interest income, income prior to income taxes and minority interest, and net income and these financial measures adjusted to exclude the impact of derivatives and foreign currency adjustments and to include minority interest in net income. Refer to Non-GAAP Financial Measures in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Form 10-K for the year ended May 31, 2006 for an explanation of why these adjustments to net income and the calculation of the TIER ratio reflect management's perspective on the Company's operations and why the Company believes these are useful financial measures for investors.

(in thousands)	Three months ended November 30,		Six months ended November 30,	
	2006	2005	2006	2005
Interest expense	\$ (245,261)	\$ (236,093)	\$ (497,716)	\$ (471,370)
Adjusted to include: Derivative cash settlements	13,163	16,816	24,869	37,016
Adjusted interest expense	\$ (232,098)	\$ (219,277)	\$ (472,847)	\$ (434,354)
Net interest income	\$ 14,983	\$ 7,233	\$ 27,217	\$ 21,833
Adjusted to include: Derivative cash settlements	13,163	16,816	24,869	37,016
Adjusted net interest income	\$ 28,146	\$ 24,049	\$ 52,086	\$ 58,849

(Loss) income prior to income taxes and minority interest	\$ (52,834)	\$ 68,366	\$ (94,036)	\$ 64,354
Adjusted to exclude: Derivative forward value	49,080	15,716	109,534	50,605
Foreign currency adjustments	20,620	(35,739)	17,299	(34,479)
Adjusted income prior to income taxes and minority interest	\$ 16,866	\$ 48,343	\$ 32,797	\$ 80,480
Net (loss) income	\$ (52,036)	\$ 63,729	\$ (92,158)	\$ 58,412
Adjusted to include: Minority interest net income	(312)	3,107	(678)	4,213
Adjusted to exclude: Derivative forward value	49,080	15,716	109,534	50,605
Foreign currency adjustments	20,620	(35,739)	17,299	(34,479)
Adjusted net income	\$ 17,352	\$ 46,813	\$ 33,997	\$ 78,751

TIER using GAAP financial measures is calculated as follows:

$$\text{TIER} = \frac{\text{Interest expense} + \text{net income prior to cumulative effect of change in accounting principle}}{\text{Interest expense}}$$

Adjusted TIER is calculated as follows:

$$\text{Adjusted TIER} = \frac{\text{Adjusted interest expense} + \text{adjusted net income}}{\text{Adjusted interest expense}}$$

The following chart provides the calculations for TIER and adjusted TIER.

	Three months ended November 30,		Six months ended November 30,	
	2006	2005	2006	2005
TIER (1)	-	1.27	-	1.12
Adjusted TIER	1.07	1.21	1.07	1.18

(1) For the three and six months ended November 30, 2006, the Company reported a net loss of \$52 million and \$92 million, respectively, thus the TIER calculation for those periods results in a value below 1.00.

#### Adjustments to the Calculation of Leverage and Debt to Equity Ratios

The following chart provides a reconciliation between the liabilities and equity used to calculate the leverage and debt to equity ratios and these financial measures adjusted to exclude the non-cash impacts of derivatives and foreign currency adjustments, to subtract debt used to fund loans that are guaranteed by RUS from total liabilities, to subtract from total liabilities, and add to total equity, debt with equity characteristics and to include minority interest as equity. Refer to Non-GAAP Financial Measures in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Form 10-K for the year ended May 31, 2006 for an explanation of why these adjustments to the calculation of leverage and debt to equity ratios reflect management's perspective on the Company's operations and why the Company believes these are useful financial measures for investors.

(in thousands)	November 30, 2006	May 31, 2006
Liabilities	\$ 18,006,436	\$ 18,369,751
Less:		
Derivative liabilities	(101,737)	(85,198)
Foreign currency valuation account	(228,700)	(244,955)
Debt used to fund loans guaranteed by RUS	(257,752)	(261,330)
Subordinated deferrable debt	(486,440)	(636,440)
Subordinated certificates	(1,426,081)	(1,427,960)
Adjusted liabilities	\$ 15,505,726	\$ 15,713,868
Total equity	\$ 610,588	\$ 787,976

Less:

Prior years cumulative derivative forward value  
and

foreign currency adjustments	(229,417)	(229,049)
Current period derivative forward value (1)	106,333	(22,962)
Current period foreign currency adjustments	17,299	22,594
Accumulated other comprehensive income	(12,706)	(13,208)
Subtotal members' equity	492,097	545,351
Plus:		
Subordinated certificates	1,426,081	1,427,960
Subordinated deferrable debt	486,440	636,440
Minority interest	21,322	21,894
Adjusted equity	\$ 2,425,940	\$ 2,631,645
Guarantees	\$ 1,143,325	\$ 1,078,980

(1) Represents the derivative forward value loss (gain) recorded by CFC for the period.

The leverage and debt to equity ratios using GAAP financial measures are calculated as follows:

$$\text{Leverage ratio} = \frac{\text{Liabilities} + \text{guarantees outstanding}}{\text{Total equity}}$$

$$\text{Debt to equity ratio} = \frac{\text{Liabilities}}{\text{Total equity}}$$

The adjusted leverage and adjusted debt to equity ratios are calculated as follows:

$$\text{Adjusted leverage ratio} = \frac{\text{Adjusted liabilities} + \text{guarantees outstanding}}{\text{Adjusted equity}}$$

$$\text{Adjusted debt to equity ratio} = \frac{\text{Adjusted liabilities}}{\text{Adjusted equity}}$$

The following chart provides the calculated ratios for leverage and debt to equity, as well as the adjusted ratio calculations. The adjusted leverage ratio and the adjusted debt to equity ratio are the same calculation except for the addition of guarantees to adjusted liabilities in the adjusted leverage ratio.

	November 30, 2006	May 31, 2006
Leverage ratio	31.36	24.68
Adjusted leverage ratio	6.86	6.38
Debt to equity ratio	29.49	23.31
Adjusted debt to equity ratio	6.39	5.97

Item 3. Quantitative and Qualitative Disclosures About Market Risk

See Market Risk discussion beginning on page 54.

Item 4. Evaluation of Disclosure Controls and Procedures

Senior management, including the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 ("the Exchange Act"). At the end of the period covered by this report, based on this evaluation process, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective. There were no changes in the Company's internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



PART II. OTHER INFORMATION

Item 1A. Risk Factors

Refer to Part I, Item 1A. Risk Factors in the Company's Form 10-K for the year ended May 31, 2006 for information regarding factors that could affect the Company's results of operations, financial condition and liquidity. There have been no changes to the Company's risk factors during the quarter ended November 30, 2006.

Item 6. Exhibits

- |        |                                                                                                         |
|--------|---------------------------------------------------------------------------------------------------------|
| 31.1 - | Certification of the Chief Executive Officer required by Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 - | Certification of the Chief Financial Officer required by Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 - | Certification of the Chief Executive Officer required by Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 - | Certification of the Chief Financial Officer required by Section 906 of the Sarbanes-Oxley Act of 2002. |



Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NATIONAL RURAL UTILITIES COOPERATIVE  
FINANCE CORPORATION

/s/ Steven L. Lilly  
Steven L. Lilly  
Chief Financial Officer

/s/ Steven L. Slepian  
Steven L. Slepian  
Controller  
(Principal Accounting Officer)

January 12, 2007