



Moody's Investors Service

## Rating Action: **Moody's affirms National Rural's ratings; outlook stable**

---

Global Credit Research - 24 Nov 2009

### **Approximately \$10.7 Billion of Debt Securities Affected.**

New York, November 24, 2009 -- Moody's Investors Service affirmed the ratings of National Rural Utilities Cooperative Finance Corporation (NRUC: A2 senior unsecured; Prime-1) and maintained NRUC's stable rating outlook.

"The rating affirmation and maintenance of a stable rating outlook reflects the continued strength of NRUC's loan portfolio, its unique market position as the dominant lender to electric distribution cooperatives, the ability of NRUC to continue producing margins consistent with its targeted adjusted TIER, adequate liquidity, and the initiatives taken by NRUC within the last year to reduce leverage over time", says A.J. Sabatelle, Senior Vice President at Moody's.

A core element of NRUC's credit strength is the durability of its loan portfolio as the dominant secured lender to electric distribution cooperatives. Moody's views this segment as being low risk and capable of producing highly predictable cash flows due to most cooperative's monopoly position as well as the cooperative's ability to pass along most cost increases to its electric customers. Loans to electric distribution cooperatives represent nearly 70% of NRUC's loan portfolio at 08/31/2009 and loans to rural electric cooperatives represent more than 90% of the total portfolio. Adding to the strength of NRUC's loan portfolio is the fact that nearly 90% of its loans are secured, which together with the portfolio's low default probability result in a loan portfolio that has historically produced very modest net loan losses. NRUC's current loan portfolio includes one large nonperforming loan to a bankrupt telecommunications company in which NRUC will likely record a sizeable net loss once a restructuring plan is in place. The rest of the loan portfolio continues to perform well with the portfolio experiencing no credit deterioration during the current recession and with loans to telecommunication borrowers, a rating concern, substantially reduced from historical levels (to 9% of the loan portfolio at 08/31/2009).

The rating affirmation recognizes NRUC's ability to weather the recent challenges for finance companies reliant on wholesale funding as a source of capital. In NRUC's case, the cooperative has gradually become somewhat less dependent on the capital markets as its member cooperatives continue to provide about 20% of total funding, and access to private financing exists from the Federal Financing Bank as part of the Rural Economic Development Loan and Grant program (REDLG) and from Federal Agricultural Mortgage Corporation (Farmer Mac). Together, both arrangements have provided NRUC with long-term funding and commitments of \$5.4 billion which Moody's views favorably from a credit perspective. Notwithstanding these funding sources, NRUC is still reliant on the capital markets in most years to principally meet maturing debt obligations. Within the last year, NRUC accessed the capital markets through the sale of collateral trust bonds and unsecured medium term notes, principally through a retail InterNotes program. Moody's observes that in most years, NRUC's amortizing loan portfolio provides at least \$1 billion of cash flow to the cooperative; however, during fiscal year 2010, NRUC expects loan amortization payments to be closer to \$1.7 billion due to several generation and transmission cooperatives repaying their respective construction bridge loans from proceeds provided by the Rural Utilities Service.

The rating affirmation factors in the credit benefits of NRUC's unique role as a not-for-profit cooperative providing a supplemental source of low-cost capital to its cooperative membership. Unlike other finance companies, NRUC is a cost-plus lender with a business model that tends to exhibit an overall lower credit risk profile as its success is not determined by achieving earnings targets, balance sheet expansion, or profitability objectives.

Balancing these factors is the degree of concentration risk that exists within NRUC's operations as well as its degree of single obligor risk within the loan portfolio. While NRUC has made some headway to deal with single obligor risk, particularly within its telecommunications portfolio, single obligor risk is likely to remain a characteristic of the NRUC lending platform.

Moody's also observes that NRUC's leverage, while on a slowly declining trend, remains relatively high

particularly given the lack of liquidity on the asset side of the balance sheet relative to other financial institutions. Within the last year, NRUC has implemented two initiatives that are intended to lower leverage over time. In November 2008, NRUC began offering member capital securities to its owners, the member cooperatives, as a means of bolstering the equity component of NRUC's capital structure. Through August 31, 2009, NRUC raised \$337 million of member capital securities and expects to continue offering the program. Also, in June 2009, as a means of increasing equity retention, NRUC revised its guidelines related to the timing and amount of patronage capital to be distributed. Under the new guidelines, NRUC will retire 50% of prior year's allocated net earnings and hold the remaining 50% for 25 years. Moody's believes these two initiatives will enable leverage, as calculated by Moody's, to continue a downward trend.

The stable rating outlook incorporates our view that modest loan growth among rural electric cooperatives will help maintain strong asset quality within the loan portfolio. To that end, we believe that the telecom portfolio, a source of loan portfolio weakness, will continue to represent less than 10% of the total loan portfolio. The stable outlook also factors in NRUC's plans to lower leverage through the offering of member capital securities and the change in NRUC's patronage retention cycle, and an expectation that NRUC will maintain sufficient liquidity as well as access to private sources of funding to mitigate the firm's reliance on wholesale funding.

In light of the still uncertain outcome with respect to NRUC's exposure to a bankrupt telecommunications borrower and the relatively high leverage, the prospect of a higher rating is limited within the next twelve months. The rating could be downgraded if a new meaningful problem loan surfaced within NRUC's portfolio, if recently implemented capital raising and capital retention efforts do not reduce NRUC's leverage over the next twelve to eighteen months, if NRUC fails to maintain an adequate liquidity profile, including ample access to multi-year bank credit facilities, or if the size of the telecom loan portfolio were to increase above 10% of the portfolio.

Ratings affirmed are NRUC's senior secured debt at A1, senior unsecured debt at A2, subordinate debt (quarterly income capital securities) at A3, and shelf registrations for senior secured debt, senior unsecured debt and subordinate debt at (P)A1, (P)A2, and (A3), respectively. NRUC's Prime-1 and VMIG-1 short-term ratings are also affirmed as well as the Prime-1 short-term rating for National Cooperative Services Corporation (NCSC). NRUC guarantees NCSC's commercial paper.

Separately, Moody's downgraded several issues of tax-exempt debt offered by municipal entities for the benefit of certain generation and transmission cooperatives, all guaranteed by NRUC. The rating change to A2 from A1 reflects a reassessment of the way in which we evaluate these securities, the majority of which were issued under a "pooled indenture" structure. The reassessment acknowledges that while the pooled indenture structure may improve recovery prospects in the event of a default, investors are primarily looking to NRUC's senior unsecured guaranty as its source of repayment. As such, these securities should carry NRUC's senior unsecured debt rating of A2.

Ratings downgraded are:

- Burlington (City of) KS, Revenue Bonds due 12/01/2015, downgraded to A2 from A1;
- Chatom (Town of) AL, Industrial Development Board Revenue Bonds, Series 2000 C due 12/01/2024, downgraded to A2 from A1;
- Chatom (Town of) AL, Revenue Bonds, Series 1984 due 08/15/2014, downgraded to A2 from A1;
- Claiborne (County of) MS, Revenue Bonds, Ser.1985-G2 due 12/01/2015, downgraded to A2 from A1;
- Claiborne (County of) MS, Revenue Bonds, Ser.1985-G1 due 12/01/2015, downgraded to A2 from A1;
- Clark (County of) KY, Revenue Bonds, Ser. J-1 due 10/15/2014, downgraded to A2 from A1;
- Clark (County of) KY, Revenue Bonds, Ser. J-2 due 10/15/2014, downgraded to A2 from A1;
- Cochise (Cnty of) AZ, Pollution Control Corp. Revenue Bonds, Series 1994-A due 09/01/2024, downgraded to A2 from A1;
- Mason (County of) KY, Revenue Bonds, SER. 1984 B due 10/15/2014, downgraded to A2 from A1;
- Pulaski (County of) KY, Revenue Bonds, Ser. 1993-B due 8/15/2023, downgraded to A2 from A1;

- Sabine River TX, Industrial Development Auth. Revenue Bonds, SER. 1984 Q due 08/15/2014, downgraded to A2 from A1

The last rating action taken on NRUC occurred on December 5, 2008 when the ratings were affirmed with a stable rating outlook.

The principal methodologies used in rating NRUC are Rating Methodology: U.S. Electric Generation & Transmission Cooperatives, published in May 2006 and Rating Methodology: Analyzing the Credit Risks of Finance Companies, published in October 2000, and are available on [www.moody.com](http://www.moody.com) in the in the Rating Methodologies sub-directory under the Research & Ratings tab. Other methodologies and factors that may have been considered in the process of rating these issuers can also be found in the Rating Methodologies sub-directory on Moody's website.

Based in Herndon, Virginia, NRUC is a private, not for profit cooperative association exclusively serving rural electric, service, and telecommunication utilities. The principal purpose of NRUC is to provide its members with a source of financing to supplement the loan programs of the Rural Utilities Service of the United States Department of Agriculture. At August 31, 2009, NRUC had total assets of approximately \$20.9 billion, of which loans to members represented approximately \$20.1 billion

New York  
A.J. Sabatelle  
Senior Vice President  
Infrastructure Finance Group  
Moody's Investors Service  
JOURNALISTS: 212-553-0376  
SUBSCRIBERS: 212-553-1653

New York  
William L. Hess  
Managing Director  
Infrastructure Finance Group  
Moody's Investors Service  
JOURNALISTS: 212-553-0376  
SUBSCRIBERS: 212-553-1653



**CREDIT RATINGS ARE MIS'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MIS DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. CREDIT RATINGS DO NOT CONSTITUTE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS ARE NOT RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. CREDIT RATINGS DO NOT COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MIS ISSUES ITS CREDIT RATINGS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.**

© Copyright 2009, Moody's Investors Service, Inc. and/or its licensors including Moody's Assurance Company, Inc. (together, "MOODY'S"). All rights reserved.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY COPYRIGHT LAW AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT. All information contained herein is obtained by MOODY'S from sources believed

by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, such information is provided "as is" without warranty of any kind and MOODY'S, in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such information. Under no circumstances shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused by, resulting from, or relating to, any error (negligent or otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, analysis, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of or inability to use, any such information. The credit ratings and financial reporting analysis observations, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER. Each rating or other opinion must be weighed solely as one factor in any investment decision made by or on behalf of any user of the information contained herein, and each such user must accordingly make its own study and evaluation of each security and of each issuer and guarantor of, and each provider of credit support for, each security that it may consider purchasing, holding or selling.

MOODY'S hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MOODY'S have, prior to assignment of any rating, agreed to pay to MOODY'S for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,400,000. Moody's Corporation (MCO) and its wholly-owned credit rating agency subsidiary, Moody's Investors Service (MIS), also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually on Moody's website at [www.moodys.com](http://www.moodys.com) under the heading "Shareholder Relations - Corporate Governance - Director and Shareholder Affiliation Policy."