National Rural Utililities Cooperative Finance Corp. Rated 'A'

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NEW YORK (Standard & Poor's) Aug. 29, 2002--Standard & Poor's Ratings Services today assigned its single-'A' rating to National Rural Utilities Cooperative Finance Corp.'s (CFC) $1.25 billion medium-term notes, while affirming all of its ratings on CFC's senior secured and senior unsecured debt, as well as on the guarantees CFC provides, CFC's quarterly income capital securities (QUICS), and CFC's commercial paper. The outlook remains negative. The proceeds from the new issuance will be used to reduce outstanding commercial paper and other corporate purposes.

"The ratings on CFC's debt are supported by its demonstrated ability to increase margins and pass through increases in funding costs to borrowers, consistent and sound financial performance, and strong security provisions and historically good asset performance that have resulted in only $106 million in net cumulative loan losses since 1969," said credit analyst Jeffrey Wolinsky.

Credit concerns include credit weakness among some of CFC's top borrowers, and uncertainty regarding the impairment of a loan to CoServ Electric following the conclusion of bankruptcy proceedings that are expected to conclude within the next 1-2 months. Standard & Poor's is also concerned about the continued high credit concentration in CFC's top 10 borrowers, and telecommunication company concentration among its top 10. The top 10 borrowers constituted 26% of total loans, and loans to rural local exchange telecom companies accounted for 25% of total loans as of May 31, 2002, down from 27% at fiscal year-end 2001. CFC is building its loan loss reserves, and has made progress in strengthening its finances, but asset quality erosion would require future additions to reserves.

CFC is strengthening its financial position. The current bond offering will be used to reduce outstanding dealer commercial paper to approximately $1.4 billion, or less than 7% of total debt from a high of approximately 21% in February 2002. CFC is also sweeping margins in excess of a 1.12 TIER to its loss reserve, provisioning $199 million for a total $507 million at May 31, 2002. CFC's reserve for the general portfolio at the end of fiscal 2002 was 1.47%, net of impaired and high-risk loans, but grew by $25 million to reach 1.59% at the end of July.

CFC will hold its ratings only if it maintains current asset quality and improves financial measures. Specifically, to maintain current ratings, Standard & Poor's expects CFC to take the following actions by the end of its fiscal 2003: raise its loan loss reserves to offset asset quality pressure from top borrowers; expand its general reserves to no less than 3%-4% (depending on portfolio credit quality) of total loans, net of impaired and high-risk loans and in addition to dollar-for-dollar reserves for all loan impairment; reduce debt-to-equity to 6-to-1 or below; and decrease the telecommunications portfolio to less than 20% of the total loan portfolio. If CFC is not able to achieve these objectives by May 31, 2003, a further downgrade may result.