

Liquidity Risk Assessment: National Rural Utilities Coop. Finance Corp.

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Herndon, Virginia, United States

Broad Industry: Public Utility
Specific Industry: Finance - Active
Short Term Rating: P-1

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Opinion

National Rural Utilities Cooperative Finance Corporation's (CFC) short-term rating of Prime-1 for commercial paper, guaranteed commercial paper issued by National Cooperative Services Corporation (NCSC), variable rate tax-exempt demand bonds, and extendible commercial notes is based on CFC's favorable competitive position; the diversity of its customers; management's track record; the quality of its loan portfolio; and a strong collateral position. The rating also considers the heavy reliance on continued debt funding to support its business strategy, CFC's leverage, and the industry and borrower concentration within its loan portfolio.

CFC is highly reliant on the capital markets as its funding source, as CFC's internal cash flow contribution from its portfolio is modest relative to its funding requirements. At May 31, 2006, CFC's members provided 19.2% of CFC's total capital base. Funding sources include commercial paper, bank bid notes, medium term notes with varying maturities, collateral trust obligation bonds, and subordinated deferrable notes. At May 31, 2006, the company had effective registration statements covering \$1.075 billion of collateral trust bonds, \$3.948 billion of medium-term notes and \$165 million of subordinated deferrable debt. The company has Board authorization to issue up to \$1.0 billion of commercial paper and \$4.0 billion of medium-term notes in the European market and \$1.5 billion of medium-term notes in the Australian market.

At May 31, 2006, CFC had approximately \$3.355 billion of commercial paper, bank bid notes, and other short-term debt outstanding with approximately \$1.989 billion in collateral trust bonds, medium-term notes and long-term notes payable scheduled to mature within one year. Of the \$3.355 billion of CFC commercial paper, bank bid notes and other short-term debt, about \$1.658 billion was dealer commercial paper, \$1.184 billion was commercial paper issued to CFC's members, \$146 million was commercial paper issued to certain nonmembers, \$100 million was bank bid notes, and \$266 million was borrowings in the daily liquidity fund, the source of which is provided by CFC's members. Moody's considers the \$1.45 billion in borrowings provided by commercial paper issued to CFC's members' and the daily liquidity fund to be a source of core funding.

Subsequent to fiscal year 2005, CFC executed two agreements which provide sizeable and highly reliable sources of capital for the company for the next few years. In June 2005, CFC entered into a bond purchase agreement with the Federal Financing Bank (FFB) and a bond guarantee agreement with the Rural Utilities Service of the U.S. Department of Agriculture (RUS) resulting in a \$2.5 billion loan facility under the Rural Electric Development Loan and Guarantee (REDLG) program. Under this program, CFC is eligible to borrow up to the amount of the outstanding loans that it has issued concurrent with RUS loans. At May 31, 2006, CFC had a total of \$2.6 billion outstanding on loans issued concurrently with RUS. Under the program, CFC will pay a fee of 30 basis points per annum to RUS for the guarantee of principal and interest payments to FFB. At May 2006, CFC had \$2 billion outstanding under the REDLG program. In a separate transaction, in July 2005, CFC sold \$500 million of 4.656% notes due in 2008 to the Federal Agricultural Mortgage Corporation (Farmer Mac) which are secured by the pledge of CFC mortgage notes.

The REDLG and Farmer Mac transactions provide more than \$2.5 billion of new capital for CFC from a new highly dependable investor base which helps to mitigate the ongoing refinancing risk associated with CFC's reliance on the short-term and long-term capital markets.

CFC has established a goal of maintaining its dealer commercial paper and bank bid notes at no more than 15% of total debt. At May 31, 2006, dealer commercial paper and bank bid notes totaled 10% of total debt outstanding.

CFC expects outstanding dealer commercial paper and bank bid notes to remain comfortably below 15% during fiscal year 2007, given the company's access to the REDLG program and expected loan repayments from CFC's portfolio.

CFC limits the amount of commercial paper issued to the amount of back-up liquidity provided by its revolving credit agreements so that there is at least 100% coverage of outstanding commercial paper. CFC's bank facilities aggregate \$4.025 billion and represent CFC's principal form of liquidity support. Of the \$4.025 billion in committed bank facilities, nearly 75% of the credit facilities have a multi-year maturity. Approximately \$1.975 billion of the facilities expire on March 23, 2010, and \$1.025 billion of the facilities expire on March 22, 2011. The remaining \$1.025 billion of these commitments expire within 364 days or by March 21, 2007; however, any borrowings outstanding under the 364-day facilities can be converted into a one-year term loan.

While none of the credit facilities contain a MAC clause they do have financial covenants whose levels provide substantial cushion. The agreements require an adjusted TIER average of 1.025 for the last six quarters (excluding any non-cash adjustments for SFAS 133/52). CFC was comfortably in compliance with this covenant. CFC runs its business and sets margins to maintain an adjusted TIER of at least 1.10x (excluding any non-cash adjustments for SFAS 133/52). Additionally, the agreement requires the leverage ratio, as defined in the bank agreement, to not be more than 10x (excluding any non-cash adjustments for SFAS 133/52). CFC was comfortably in compliance, with a leverage ratio as defined by the bank agreement of 6.26x at May 31, 2006.

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