Credit Opinion: National Rural Utilities Coop. Finance Corp.

National Rural Utilities Coop. Finance Corp.

Herndon, Virginia, United States

Ratings

Category	Moody's Rating
Outlook	Stable
Senior Secured	A1
Senior Unsecured	A2
Subordinate	A3
Commercial Paper	P-1
Other Short Term	P-1

Contacts

Analyst	Phone
A.J. Sabatelle/New York	1.212.553.1653
Michael G. Haggarty/New York	
Daniel Gates/New York	

Key Indicators

National Rural Utilities Coop. Finance Corp.	1Q05 TTM	2004	2003	2002	2001
Loans ($millions) [1]	20,472	20,489	19,484	20,047	19,684
Adjusted Capital Funds ($millions) [1][2]	2,121	2,148	2,163	2,084	1,976
Adjusted TIER (x) [1][3]	1.11	1.12	1.17	1.12	1.12
Adjusted Debt / Adjusted Capital Funds (x) [1][2]	8.50	8.38	7.91	8.29	8.77
Adjusted Debt+ QUICS / Adjusted Capital Funds (x) [1][2]	8.76	8.63	8.21	8.57	9.05
Loan Loss Reserve ($millions) [1][4]	574	574	511	478	317
Loan Loss Reserve / Loans (%) [1][4]	2.80%	2.80%	2.62%	2.38%	1.61%
Adjusted Short Term Debt / Adjusted Capitalization (%) [1][2]	6.7%	6.5%	4.8%	12.1%	30.0%

[1] Fiscal year ends May 31st [2] Members' Equity is adjusted for SFAS 133 and SFAS 52 [3] Net margin adjusted to exclude derivative forward value and foreign currency adjustments. Cost of funds adjusted to include derivative cash settlements. [4] Excludes loss reserves for guarantee portfolio of $18, $19, $53, $28, and $15 million for 1Q05, 2004, 2003, 2002, and 2001 respectively.

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Credit Strengths

Credit strengths for CFC are:

- Loan pricing flexibility enables CFC to reset margins sufficient to maintain its targeted coverage ratios while adding to its loan loss reserve.

-Outstanding credit quality of CFC's loan portfolio, including its loan loss history, and its strong collateral position on more than 90% of its loans.

-CoServ loan restructuring is performing as expected.

-CFC's foreclosed asset portfolio, which largely relates to the CoServ restructuring, continues to monetize with CFC receiving $154 million in net cash proceeds from various transactions since May 2003.

-CFC's loan loss reserve has increased by $346 million (or by 152%) to $574 million at August 2004 and May 2004 from $228 million at May 2000.

-Management has a strong track record of being able to effectively manage difficult credit restructurings.

-While the size of CFC's telecom loan portfolio is a concern, the total size of the loan portfolio has declined materially and a substantial portion of the remaining telecom portfolio consists of loans to rural local exchange carriers.

Credit Challenges

Credit challenges for CFC are:

-Single obligor exposure, while reduced following the refinancing of two large telecom loans during the second quarter 2004, remains an ongoing risk, particularly given the lack of liquidity on the asset side of the balance sheet.

-CFC's rural telecom loan portfolio, while declining by nearly $1.5 billion since fiscal year-end 2003, represents about 18% of CFC's total loan portfolio at November 30, 2004.

-CFC is highly reliant on the short-term and long-term capital markets for funding its business and for refinancing maturing debt.

-CFC has a $199 million non-performing loan exposure to a borrower which filed for Chapter 11 in

November 2004.

-CFC is currently involved in litigation with a telecom borrower in which CFC had $550 million of loan exposure at August 31, 2004.

-CFC's leverage remains high particularly given the lack of liquidity on the asset side of the balance sheet.

Rating Rationale

The A1 senior secured debt rating of National Rural Utilities Cooperative Finance Corporation (CFC) is based on its excellent competitive position, including an ability to easily raise margins on member loans; management's strong track record; and the quality of its loan portfolio, which has an outstanding loan loss history and a strong collateral position.

The rating also considers the single obligor exposure within the loan portfolio; the reliance on debt to fund its business; the size of its telecom portfolio; and the credit quality of some of CFC's larger credit exposures. To that end, the rating factors in the problem loan exposure with VarTec and the litigation that exists between CFC and one of its borrowers, ICC.

Moody's notes that within the past few years, CFC has slowed the growth of the portfolio, increased its loan loss reserve, reduced its reliance on short-term debt as a funding source, and reduced the size of its telecom loan portfolio. Specifically, the telecom portfolio has declined by $1.1 billion since fiscal year end 2004 due to the refinancing of two large telecom loans and normal amortization of the loan portfolio.

Rating Outlook

CFC's stable outlook considers a continuation of fairly modest loan growth, maintenance of a healthy loan loss reserve, a continued decline in the telecom loan portfolio, and no material additions to the problem loan portfolio. The stable outlook assumes that reasonable outcomes occur for CFC's loan exposures with CoServ, VarTec, and ICC.

What Could Change the Rating - UP

CFC's stable rating outlook reflects the view that the inherent characteristics of CFC's business, including large single obligor exposure and the near-term challenges that it faces with a number of these exposures, make a rating upgrade unlikely in the near term.

What Could Change the Rating - DOWN

Unfavorable resolution of the CoServ restructuring, the VarTec bankruptcy or the litigation with ICC could weaken credit quality. Also, credit deterioration from a new large loan exposure or a material and unjustifiable reduction in the loan loss reserve could place downward pressure on the rating.