YRC Worldwide Inc.
Form 10-Q
April 30, 2015


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

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2015
OR
o 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: 0-12255

YRC Worldwide Inc.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 48-0948788 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 10990 Roe Avenue, Overland Park, Kansas | 66211 |
| (Address of principal executive offices) | (Zip Code) |

(913) 696-6100
(Registrant's telephone number, including area code)
None
(Former name, former address and former fiscal year, if changed since last report)

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 ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

| | | | |
|---|---|---|---|
| Large accelerated filer | ý | Accelerated filer | o |

| | | | |
|---|---|---|---|
| Non-accelerated filer | o (Do not check if a smaller reporting company) | Smaller reporting company | o |

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class | Outstanding at April 24, 2015 |
|---|---|
| Common Stock, $0.01 par value per share | 32,752,973 shares |

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PART I—FINANCIAL INFORMATION
Item 1. Financial Statements
CONSOLIDATED BALANCE SHEETS
YRC Worldwide Inc. and Subsidiaries
(Amounts in millions except share and per share data)

| | March 31, 2015 (Unaudited) | December 31, 2014 |
|---|---|---|
| Assets | | |
| Current Assets: | | |
| Cash and cash equivalents | $136.4 | $171.1 |
| Restricted amounts held in escrow | 17.9 | 28.9 |
| Accounts receivable, net | 515.5 | 470.5 |
| Prepaid expenses and other | 89.8 | 81.2 |
| Total current assets | 759.6 | 751.7 |
| Property and Equipment: | | |
| Cost | 2,830.5 | 2,819.6 |
| Less – accumulated depreciation | (1,859.5) | (1,825.4) |
| Net property and equipment | 971.0 | 994.2 |
| Intangibles, net | 54.9 | 60.3 |
| Restricted amounts held in escrow | 60.2 | 60.2 |
| Deferred income taxes, net | 21.2 | 21.4 |
| Other assets | 99.3 | 97.2 |
| Total Assets | $1,966.2 | $1,985.0 |
| Liabilities and Shareholders' Deficit | | |
| Current Liabilities: | | |
| Accounts payable | $204.6 | $172.2 |
| Wages, vacations and employee benefits | 189.0 | 176.6 |
| Deferred income taxes, net | 21.2 | 21.4 |
| Other current and accrued liabilities | 181.9 | 202.2 |
| Current maturities of long-term debt | 14.2 | 31.1 |
| Total current liabilities | 610.9 | 603.5 |
| Other Liabilities: | | |
| Long-term debt, less current portion | 1,074.0 | 1,078.8 |
| Deferred income taxes, net | 1.1 | 1.5 |
| Pension and postretirement | 447.7 | 460.3 |
| Claims and other liabilities | 312.2 | 315.2 |
| Commitments and contingencies | | |
| Shareholders' Deficit: | | |
| Preferred stock, $1 par value per share | — | — |
| Common stock, $0.01 par value per share | 0.3 | 0.3 |
| Capital surplus | 2,307.7 | 2,290.9 |
| Accumulated deficit | (2,261.6) | (2,240.0) |
| Accumulated other comprehensive loss | (433.4) | (432.8) |
| Treasury stock, at cost (410 shares) | (92.7) | (92.7) |
| Total shareholders' deficit | (479.7) | (474.3) |
| Total Liabilities and Shareholders' Deficit | $1,966.2 | $1,985.0 |

The accompanying notes are an integral part of these statements.

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STATEMENTS OF CONSOLIDATED COMPREHENSIVE LOSS
YRC Worldwide Inc. and Subsidiaries
For the Three Months Ended March 31
(Amounts in millions except per share data, shares in thousands)
(Unaudited)

| | Three Months | |
|---|---|---|
| | 2015 | 2014 |
| Operating Revenue | $1,186.4 | $1,210.9 |
| Operating Expenses: | | |
| Salaries, wages and employee benefits | 707.3 | 725.7 |
| Operating expenses and supplies | 228.2 | 283.7 |
| Purchased transportation | 133.4 | 131.9 |
| Depreciation and amortization | 41.6 | 41.0 |
| Other operating expenses | 70.9 | 60.8 |
| Losses on property disposals, net | 1.3 | 0.2 |
| Total operating expenses | 1,182.7 | 1,243.3 |
| Operating Income (Loss) | 3.7 | (32.4) |
| Nonoperating Expenses: | | |
| Interest expense | 27.6 | 58.2 |
| (Gain) loss on extinguishment of debt | 0.6 | (11.2) |
| Other, net | (4.3) | (5.1) |
| Nonoperating expenses, net | 23.9 | 41.9 |
| Loss before income taxes | (20.2) | (74.3) |
| Income tax (benefit) expense | 1.4 | (4.1) |
| Net loss | (21.6) | (70.2) |
| Amortization of beneficial conversion feature on preferred stock | — | (18.1) |
| Net Loss Attributable to Common Shareholders | (21.6) | (88.3) |
| | | |
| Net loss | (21.6) | (70.2) |
| Other comprehensive income (loss), net of tax | (0.6) | 0.9 |
| Comprehensive Loss Attributable to YRC Worldwide Inc. | $(22.2) | $(69.3) |
| | | |
| Average Common Shares Outstanding – Basic | 30,799 | 22,344 |
| Average Common Shares Outstanding – Diluted | 30,799 | 22,344 |
| | | |
| Loss Per Share – Basic | $(0.70) | $(3.95) |
| Loss Per Share – Diluted | $(0.70) | $(3.95) |

The accompanying notes are an integral part of these statements.

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STATEMENTS OF CONSOLIDATED CASH FLOWS
YRC Worldwide Inc. and Subsidiaries
For the Three Months Ended March 31
(Amounts in millions)
(Unaudited)

| | 2015 | 2014 |
|---|---|---|
| Operating Activities: | | |
| Net loss | $(21.6) | $(70.2) |
| Noncash items included in net loss: | | |
| Depreciation and amortization | 41.6 | 41.0 |
| Paid-in-kind interest on Series A Notes and Series B Notes | 0.4 | 10.1 |
| Amortization of deferred debt costs | 1.6 | 3.3 |
| Amortization of premiums and discounts on debt | 1.0 | 17.7 |
| Equity based compensation expense | 0.5 | 6.6 |
| Losses on property disposals, net | 1.3 | 0.2 |
| (Gain) loss on extinguishment of debt | 0.6 | (11.2) |
| Other noncash items, net | (1.9) | (3.3) |
| Changes in assets and liabilities, net: | | |
| Accounts receivable | (46.4) | (75.4) |
| Accounts payable | 25.6 | 37.2 |
| Other operating assets | (7.1) | (16.9) |
| Other operating liabilities | (21.4) | 4.7 |
| Net cash used in operating activities | (25.8) | (56.2) |
| Investing Activities: | | |
| Acquisition of property and equipment | (21.3) | (11.7) |
| Proceeds from disposal of property and equipment | 5.5 | 0.6 |
| Restricted escrow receipts | 21.0 | 90.7 |
| Restricted escrow deposits | (10.0) | (171.6) |
| Other, net | 0.4 | 3.4 |
| Net cash used in investing activities | (4.4) | (88.6) |
| Financing Activities: | | |
| Issuance of long-term debt | — | 693.0 |
| Repayments of long-term debt | (4.5) | (789.5) |
| Debt issuance costs | — | (27.4) |
| Equity issuance costs | — | (17.1) |
| Equity issuance proceeds | — | 250.0 |
| Net cash (used in) provided by financing activities | (4.5) | 109.0 |
| Net Decrease In Cash and Cash Equivalents | (34.7) | (35.8) |
| Cash and Cash Equivalents, Beginning of Period | 171.1 | 176.3 |
| Cash and Cash Equivalents, End of Period | $136.4 | $140.5 |
| | | |
| Supplemental Cash Flow Information: | | |
| Interest paid | $(25.6) | $(39.4) |
| Income tax refund, net | $2.2 | $13.6 |

The accompanying notes are an integral part of these statements.

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STATEMENT OF CONSOLIDATED SHAREHOLDERS' DEFICIT
YRC Worldwide Inc. and Subsidiaries
For the Three Months Ended March 31, 2015
(Amounts in millions)
(Unaudited)

| | | |
|---|---|---|
| Preferred Stock: | | |
| Beginning and ending balance | $— | |
| Common Stock: | | |
| Beginning and ending balance | $0.3 | |
| Capital Surplus: | | |
| Beginning balance | $2,290.9 | |
| Share-based compensation | (1.7 | ) |
| Issuance of equity upon conversion and exchange of Series B Notes | 18.5 | |
| Ending balance | $2,307.7 | |
| Accumulated Deficit: | | |
| Beginning balance | $(2,240.0 | ) |
| Net loss | (21.6 | ) |
| Ending balance | $(2,261.6 | ) |
| Accumulated Other Comprehensive Loss: | | |
| Beginning balance | $(432.8 | ) |
| Reclassification of net pension actuarial losses to net loss, net of tax | 4.1 | |
| Foreign currency translation adjustments | (4.7 | ) |
| Ending balance | $(433.4 | ) |
| Treasury Stock, At Cost: | | |
| Beginning and ending balance | $(92.7 | ) |
| Total Shareholders' Deficit | $(479.7 | ) |

The accompanying notes are an integral part of these statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YRC Worldwide Inc. and Subsidiaries
(Unaudited)

Certain of these Notes to Consolidated Financial Statements contain forward-looking statements, as described in “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Cautionary Note Regarding Forward-Looking Statements.”

1. Description of Business

YRC Worldwide Inc. (also referred to as “YRC Worldwide,” the “Company,” “we,” “us” or “our”) is a holding company that, through wholly owned operating subsidiaries and its interest in a Chinese joint venture, offers its customers a wide range of transportation services. We have one of the largest, most comprehensive less-than-truckload (“LTL”) networks in North America with local, regional, national and international capabilities. Through our team of experienced service professionals, we offer expertise in LTL shipments and flexible supply chain solutions, ensuring customers can ship industrial, commercial and retail goods with confidence. Our reporting segments include the following:

- YRC Freight is the reporting segment that focuses on longer haul business opportunities with national, regional and international services. YRC Freight provides for the movement of industrial, commercial and retail goods, primarily through centralized management and customer facing organizations. This reporting segment includes our LTL subsidiary YRC Inc. (“YRC Freight”) and Reimer Express (“YRC Reimer”), a subsidiary located in Canada that specializes in shipments into, across and out of Canada. In addition to the United States and Canada, YRC Freight also serves parts of Mexico, Puerto Rico and Guam.

- Regional Transportation is the reporting segment for our transportation service providers focused on business opportunities in the regional and next-day delivery markets. Regional Transportation is comprised of USF Holland Inc. (“Holland”), New Penn Motor Express, Inc. (“New Penn”) and USF Reddaway Inc. (“Reddaway”). These companies each provide regional, next-day ground services in their respective regions through a network of facilities located across the United States, Canada, Mexico and Puerto Rico.

At March 31, 2015, approximately 78% of our labor force is subject to collective bargaining agreements, which predominantly expire in March 2019.

2. Principles of Consolidation

The accompanying Consolidated Financial Statements include the accounts of YRC Worldwide and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. We report on a calendar year basis. The quarters of the Regional Transportation companies (with the exception of New Penn) consist of thirteen weeks that end on a Saturday either before or after the end of March, June and September, whereas all other operating segment quarters end on the natural calendar quarter end. Our investment in our non-majority owned affiliate is accounted for on the equity method.

We make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and notes. Actual results could differ from those estimates. We have prepared the Consolidated Financial Statements, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). In our opinion, all normal recurring adjustments necessary for a fair statement of the financial position, results of operations and cash flows for the interim periods included in these financial statements herein have been made. Certain information and note disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles (“GAAP”) have been condensed or omitted from these statements pursuant to SEC rules and regulations.

Accordingly, the accompanying Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2014.

Fair Value of Financial Instruments

The following table summarizes the fair value hierarchy of our financial assets and liabilities carried at fair value on a recurring basis as of March 31, 2015:

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| (in millions) | Total Carrying Value | Fair Value Measurement Hierarchy Quoted prices in active market (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
|---|---|---|---|---|
| Restricted amounts held in escrow-current | $17.9 | $17.9 | $— | $— |
| Restricted amounts held in escrow-long term | 60.2 | 60.2 | — | — |
| Total assets at fair value | $78.1 | $78.1 | $— | $— |

Restricted amounts held in escrow are invested in money market accounts and are recorded at fair value based on quoted market prices. The carrying value of cash and cash equivalents, accounts receivable and accounts payable approximates their fair value due to the short-term nature of these instruments.

Reclassifications Out of Accumulated Other Comprehensive Loss

For the three months ended March 31, 2015 and 2014, we reclassified the amortization of our net pension loss totaling $4.1 million and $2.0 million, respectively, net of tax, from accumulated other comprehensive loss to net loss. This reclassification is a component of net periodic pension cost and is discussed in the “Employee Benefits” footnote.

Impact of Recently Issued Accounting Standards

In April 2015, the Financial Accounting Standards Board (“FASB”) issued new authoritative literature, Interest - Imputation of Interest, which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with the accounting treatment for debt discounts. The recognition and measurement guidance of debt issuance costs are not affected by this update. The guidance, which requires retrospective application, is effective for the Company beginning January 1, 2016, but early adoption is allowed. The Company is currently evaluating this newly-issued guidance and the impact it will have on our Consolidated Financial Statements.

## 3. 2014 Financing Transactions

On January 31, 2014, we issued 14,333,334 shares of our Common Stock and 583,334 shares of our Convertible Preferred Stock pursuant to certain stock purchase agreements, dated as of December 22, 2013 (the “Stock Purchase Agreements”), for an aggregate $250.0 million in cash. We used the proceeds from these transactions to, among other things, (i) repay our 6% Convertible Senior Notes (“6% Notes”) at their maturity on February 15, 2014 and (ii) repurchase $90.9 million of our Series A Convertible Senior Secured Notes (“Series A Notes”). In February 2014, the Company deposited $89.6 million with the trustee to fund the redemption (including accrued interest), and thereby discharged the indenture governing the Series A Notes. The Company used the cash deposited with the trustee to redeem its Series A Notes on August 5, 2014.

Also on January 31, 2014, certain holders of our 10% Series B Convertible Senior Secured Notes (“Series B Notes”) exchanged their outstanding balances at a conversion price of $15.00 per share, while another holder converted its Series B Notes in accordance with their existing terms. We also amended the indenture governing our Series B Notes to eliminate substantially all of the restrictive covenants, certain events of default and other related provisions contained in the indenture and to release and discharge the liens on the collateral securing the Series B Notes.

Effective January 31, 2014, certain of our subsidiaries, various pension funds party thereto, and Wilmington Trust Company, as agent for such pension funds, entered into the Second Amended and Restated Contribution Deferral

Agreement ("Second A&R CDA"), which, among other things (i) amended and restated the Amended and Restated Contribution Deferral Agreement ("A&R CDA"), (ii) released the agent's security interest in third priority collateral on the Collateral Release Date, (iii) limited the value of obligations secured by the collateral to the Secured Obligations and (iv) extended the maturity of deferred pension payments and deferred interest from March 31, 2015 to December 31, 2019.

On February 13, 2014, we replaced our prior credit facilities with a new $450 million asset-based loan (the "ABL Facility") and a new $700 million term loan facility ("Term Loan"). The ABL Facility supports our outstanding letters of credit commitments.

We refer to transactions described above collectively as the "2014 Financing Transactions." The table below summarizes the cash flow activity for the 2014 Financing Transactions:

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| Cash Sources (in millions) | | Cash Uses (in millions) | |
|---|---|---|---|
| Term Loan | $700.0 | Extinguish prior ABL facility (includes accrued interest) | $326.0 |
| Proceeds from sale of common stock | 215.0 | Extinguish prior term loan (includes accrued interest) | 299.7 |
| Proceeds from sale of convertible preferred stock | 35.0 | Retire 6% Notes | 71.5 |
| Cash proceeds from restricted amounts held in escrow - Prior ABL facility | 90.0 | Repurchase Series A Notes (includes accrued interest) | 93.9 |
| ABL Facility | — | Redeem Series A Notes (on August 5, 2014 and includes accrued interest) | 89.6 |
| | | Fees, expenses and original issuance discount | 50.8 |
| | | Restricted cash to balance sheet [(a)] | 92.0 |
| | | Cash to balance sheet | 16.5 |
| Total sources | $1,040.0 | Total uses | $1,040.0 |

(a) Under the terms of the ABL Facility, this amount was classified as “restricted cash” in the consolidated balance sheet at the closing date of the ABL Facility.

The table below summarizes the non-cash activity for the 2014 Financing Transactions:

| Non-Cash Sources (in millions) | | Non-Cash Uses (in millions) | |
|---|---|---|---|
| Secured Second A&R CDA | $51.0 | A&R CDA | $124.2 |
| Unsecured Second A&R CDA | 73.2 | Exchange/conversion of Series B Notes to common stock | 50.6 |
| Exchange/conversion of Series B Notes to common stock | 50.6 | | |
| Total sources | $174.8 | Total uses | $174.8 |

We accounted for the A&R CDA maturity extension as a debt modification and the remaining transactions as extinguishment of debt and issuance of new debt. We recorded a gain on extinguishment of debt of $11.2 million associated with this transaction during the three months ended March 31, 2014, $16.3 million of which related to the acceleration of net premiums on our old debt, partially offset by $5.1 million of additional expense related to the fair value of the incremental shares provided to those Series B Note holders who exchanged their outstanding balances at a conversion price of $15.00 per share. We recorded, in “interest expense” on the statements of consolidated comprehensive loss, $8.0 million of make-whole interest related to the Series B Notes exchanged during the three months ended March 31, 2014. We paid $43.8 million of fees associated with these transactions of which $26.7 million was recorded as unamortized deferred debt costs in “other assets” in the consolidated balance sheet in the first quarter of 2014 and will be recognized as interest expense over the term of the Term Loan and ABL Facility and $17.1 million offset the equity proceeds of our stock purchase agreements.

On March 14, 2014, the Company held a special meeting of stockholders at which our stockholders approved amending our Certificate of Incorporation to increase the number of authorized shares of Common Stock and to allow an individual investor to own more than 19.99% of outstanding Common Stock. Upon approval of these amendments, each outstanding share of Convertible Preferred Stock automatically converted into four shares of Common Stock and the Company recorded $18.1 million related to the amortization of the beneficial conversion feature on preferred stock on the statements of consolidated comprehensive loss.

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4. Debt and Financing

Our outstanding debt as of March 31, 2015 and December 31, 2014 consisted of the following:

| As of March 31, 2015 (in millions) | Par Value | Discount | Book Value | Stated Interest Rate | Average Effective Interest Rate |
|---|---|---|---|---|---|
| Term Loan | $691.3 | $(5.4) | $685.9 | 8.3% | 8.5% |
| ABL Facility[a] | — | — | — | N/A | N/A |
| Secured Second A&R CDA | 46.2 | — | 46.2 | 3.3-18.3% | 7.3% |
| Unsecured Second A&R CDA | 73.2 | — | 73.2 | 3.3-18.3% | 7.3% |
| Lease financing obligations | 282.7 | — | 282.7 | 10.0-18.2% | 12.0% |
| Other | 0.2 | — | 0.2 | | |
| Total debt | $1,093.6 | $(5.4) | $1,088.2 | | |
| Current maturities of Term Loan | (7.0) | — | (7.0) | | |
| Current maturities of lease financing obligations | (7.0) | — | (7.0) | | |
| Current maturities of other | (0.2) | — | (0.2) | | |
| Long-term debt | $1,079.4 | $(5.4) | $1,074.0 | | |

(a) As of March 31, 2015, the borrowing base and availability on our ABL Facility were $450.0 million and $84.2 million, respectively. The availability is calculated in accordance with the terms of the ABL Facility and is derived by reducing the borrowing base by our $365.8 million of outstanding letters of credit as of March 31, 2015. The amount which is actually able to be drawn is limited by certain financial covenants in the ABL Facility to $39.2 million.

| As of December 31, 2014 (in millions) | Par Value | Premium/ (Discount) | Book Value | Stated Interest Rate | Average Effective Interest Rate |
|---|---|---|---|---|---|
| Term Loan | $693.0 | $(5.7) | $687.3 | 8.3% | 8.5% |
| ABL Facility[a] | — | — | — | N/A | N/A |
| Series B Notes | 17.7 | (0.6) | 17.1 | 10.0% | 25.6% |
| Secured Second A&R CDA | 47.0 | — | 47.0 | 3.3-18.3% | 7.3% |
| Unsecured Second A&R CDA | 73.2 | — | 73.2 | 3.3-18.3% | 7.3% |
| Lease financing obligations | 285.1 | — | 285.1 | 10.0-18.2% | 12.0% |
| Other | 0.2 | — | 0.2 | | |
| Total debt | $1,116.2 | $(6.3) | $1,109.9 | | |
| Current maturities of Term Loan | (7.0) | — | (7.0) | | |
| Current maturities of Series B Notes | (17.7) | 0.6 | (17.1) | | |
| Current maturities of lease financing obligations | (6.8) | — | (6.8) | | |
| Current maturities of other | (0.2) | — | (0.2) | | |
| Long-term debt | $1,084.5 | $(5.7) | $1,078.8 | | |

(a) As of December 31, 2014, the borrowing base and availability on our ABL Facility were $445.5 million and $71.2 million, respectively. The availability is calculated in accordance with the terms of the ABL Facility and is derived by reducing the borrowing base by our $374.3 million of outstanding letters of credit as of December 31, 2014. The amount which is actually able to be drawn is limited by certain financial covenants in the ABL Facility to $27.1 million.

Series B Exchange

Our Series B Notes, which matured on March 31, 2015, were convertible into our common stock, at the conversion price per share of approximately $18.5334 and a conversion rate of 53.9567 common shares per $1,000 of the Series B Notes (such conversion price and conversion rate applying also to the Series B Notes make whole premium).

On March 25, 2015, we entered into an exchange agreement with certain holders of our Series B Notes to exchange their outstanding principal and accrued interest balances totaling $17.9 million at conversion price of $18.00 per share for an aggregate 994,689 shares of Common Stock. During the three months ended March 31, 2015, we recorded $0.6 million of additional expense related

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to the fair value of the incremental shares provided to those holders who exchanged their outstanding balances. At maturity on March 31, 2015, we repaid the holders of the remaining outstanding Series B Notes approximately $0.3 million of cash.

As discussed in the "2014 Financing Transactions" footnote, on January 31, 2014, certain holders of our Series B Notes exchanged their outstanding notes as part of an exchange agreement. Outside of these exchange agreements, during the three months ended March 31, 2014, $1.2 million of aggregate principal amount of Series B Notes were converted into 75,900 shares of our common stock, which includes the make whole premium. Upon conversion, during the three months ended March 31, 2014, we recorded $0.4 million of additional interest expense representing the $0.2 million make whole premium and $0.2 million of accelerated amortization of the discount on converted Series B Notes.

Fair Value Measurement

The carrying amounts and estimated fair values of our long-term debt, including current maturities and other financial instruments, are summarized as follows:

| | March 31, 2015 | | December 31, 2014 | |
|---|---|---|---|---|
| (in millions) | Carrying amount | Fair Value | Carrying amount | Fair Value |
| Term Loan | $685.9 | $681.6 | $687.3 | $685.4 |
| Series B Notes | — | — | 17.1 | 17.7 |
| Lease financing obligations | 282.7 | 282.7 | 285.1 | 282.2 |
| Other | 119.6 | 117.9 | 120.4 | 119.1 |
| Total debt | $1,088.2 | $1,082.2 | $1,109.9 | $1,104.4 |

The fair values of the Term Loan, ABL Facility, Series B Notes and the Secured and Unsecured A&R CDA (included in "Other" above) were estimated based on observable prices (level two inputs for fair value measurements). The fair value of the lease financing obligations is estimated using a publicly traded secured loan with similar characteristics (level three input for fair value measurement).

5. Liquidity

For a description of our outstanding debt as of March 31, 2015, please refer to the "Debt and Financing" footnote in our Consolidated Financial Statements.

Credit Facility Covenants

Our Term Loan credit agreement has certain financial covenants that, among other things, restricts certain capital expenditures and requires us to maintain a maximum total leverage ratio (defined as Consolidated Total Debt divided by Consolidated Adjusted EBITDA as defined below). On September 25, 2014, the Company entered into Amendment No. 1 to its Credit Agreement (the "Credit Agreement Amendment"), which amended the Term Loan to, among other things, adjust the maximum permitted total leverage ratio through December 31, 2016 and increase the applicable interest rate over the same period.

Our Credit Agreement Amendment total maximum leverage ratio covenants are as follows:

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| Four Consecutive Fiscal Quarters Ending | Maximum Total Leverage Ratio | Four Consecutive Fiscal Quarters Ending | Maximum Total Leverage Ratio |
|---|---|---|---|
| March 31, 2015 | 5.00 to 1.00 | September 30, 2016 | 3.75 to 1.00 |
| June 30, 2015 | 4.75 to 1.00 | December 31, 2016 | 3.50 to 1.00 |
| September 30, 2015 | 4.50 to 1.00 | March 31, 2017 | 3.25 to 1.00 |
| December 31, 2015 | 4.25 to 1.00 | June 30, 2017 | 3.25 to 1.00 |
| March 31, 2016 | 4.00 to 1.00 | September 30, 2017 | 3.25 to 1.00 |
| June 30, 2016 | 3.75 to 1.00 | December 31, 2017 and thereafter | 3.00 to 1.00 |

Consolidated Adjusted EBITDA, defined in our Credit Agreement Amendment as “Consolidated EBITDA,” is a measure that reflects our earnings before interest, taxes, depreciation, and amortization expense, and is further adjusted for, among other things, letter of credit fees, equity-based compensation expense, net gains or losses on property disposals and certain other items, including restructuring professional fees, nonrecurring consulting fees, expenses associated with certain lump sum payments to our International Brotherhood of Teamsters (“IBT”) employees and the results of permitted dispositions and discontinued operations. Consolidated Total Debt, as defined in our Credit Agreement Amendment, is the aggregate principal amount of indebtedness outstanding. Our total leverage ratio for the four consecutive fiscal quarters ended March 31, 2015 was 3.90 to 1.00.

We believe that our results of operations will be sufficient to allow us to comply with the covenants in the Credit Agreement Amendment, fund our operations, increase working capital as necessary to support our planned revenue growth and fund capital expenditures for at least the next twelve months. In order for us to maintain compliance with the maximum total leverage ratio over the tenor of the Term Loan, we must achieve operating results which reflect continuing improvement over our recent results.

Our ability to satisfy our liquidity needs and meet future stepped-up covenant requirements is primarily dependent on improving our profitability. Improvements to our profitability include continued successful implementation and realization of productivity and efficiency initiatives as well as increased volume and pricing improvements, some of which are outside of our control.

In the event our operating results indicate we will not meet our maximum total leverage ratio, we will take action to improve our maximum total leverage ratio which may include paying down our outstanding indebtedness with either cash on hand or from cash proceeds from equity issuances. The issuance of equity is outside of our control and there can be no assurance that we will be able to issue additional equity at terms that are agreeable to us or that we would have sufficient cash on hand to pay down debt in order to meet the maximum total leverage ratio.

Risks and Uncertainties Regarding Future Liquidity

Our principal sources of liquidity are cash and cash equivalents, available borrowings under our ABL Facility and any prospective net operating cash flows from operations. The unused line of credit that may actually be drawn is limited by certain financial covenants. As of March 31, 2015, the amount that actually may be drawn on the ABL Facility was $39.2 million. As of March 31, 2015, we had cash and cash equivalents of $136.4 million, and cash and cash equivalents and amounts able to be drawn on our ABL Facility totaling $175.6 million. For the three months ended March 31, 2015, we used net cash of $25.8 million for our operating activities.

Our principal uses of cash are to fund our operations, including making contributions to our single-employer pension plans and various multi-employer pension funds, and to meet our other cash obligations including, but not limited to, paying cash interest and principal on our funded debt, payments on our equipment leases and funding capital expenditures.

Our ABL Facility credit agreement, among other things, restricts certain capital expenditures and requires that the Company, in effect, maintain availability of at least 10% of the lesser of the aggregate amount of commitments from all lenders or the borrowing base.

We have a considerable amount of indebtedness. As of March 31, 2015, we had $1,093.6 million in aggregate par value of outstanding indebtedness, the majority of which matures in 2019. We also have considerable future funding obligations for our single-employer pension plans and various multi-employer pension funds. We expect our funding obligations for the remainder of 2015 for our single-employer pension plans and multi-employer pension funds will be $47.0 million and $66.1 million, respectively. In addition, we have, and will continue to have, substantial operating lease obligations. As of March 31, 2015, our

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minimum rental expense under operating leases for the remainder of the year is $48.7 million. As of March 31, 2015, our operating lease obligations through 2025 totaled $206.4 million and is expected to increase as we lease additional revenue equipment.

Our capital expenditures for the three months ended March 31, 2015 and 2014 were $21.3 million and $11.7 million, respectively. These amounts were primarily for purchases of used tractors and trailers and refurbished engines for our revenue fleet. Additionally, for the three months ended March 31, 2015, we entered into new operating leases for revenue equipment for $47.6 million, payable over the average lease term of four years.

6. Employee Benefits

The following table presents the components of our company-sponsored pension costs for the three months ended March 31:

| | Three Months | |
|---|---|---|
| (in millions) | 2015 | 2014 |
| Service cost | $1.2 | $1.0 |
| Interest cost | 14.3 | 15.2 |
| Expected return on plan assets | (15.0) | (13.4) |
| Amortization of net pension loss | 4.0 | 3.2 |
| Total periodic pension cost | $4.5 | $6.0 |

We expect to contribute $60.3 million to our company-sponsored pension plans in 2015 of which we have contributed $13.3 million through March 31, 2015.

7. Income Taxes

Our effective tax rate for the three months ended March 31, 2015 was (6.9)%, compared to 5.5% for the three months ended March 31, 2014 . The significant items impacting the 2015 rate include a net state and foreign tax provision, certain permanent items, and a change in the valuation allowance established for the net deferred tax asset balance projected for December 31, 2015. We recognize valuation allowances on deferred tax assets if, based on the weight of the evidence, we determine it is more likely than not such assets will not be realized. Changes in valuation allowances are included in our tax provision in the period of change. In determining whether a valuation allowance is warranted, we evaluate factors such as prior years' earnings history, expected future earnings, loss carry-back and carry-forward periods, reversals of existing deferred tax liabilities and tax planning strategies that potentially enhance the likelihood of the realization of a deferred tax asset. At March 31, 2015 and December 31, 2014, substantially all of our net deferred tax assets were subject to a valuation allowance.

Customarily, a loss before income taxes would generate income tax benefit. Our income tax expense reported for the three months ended March 31, 2015, notwithstanding the corresponding loss before income taxes, results from foreign and certain state taxable income; no net U.S. federal benefit is recognizable after the required valuation allowance for an expected federal loss carryforward.

Concurrent with the financing transactions of January 31, 2014 described in the "2014 Financing Transactions" footnote, the Company experienced a change of ownership as described in Section 382 of the Internal Revenue Code. The impact of the 2014 ownership change on the Company's ability to utilize its Net Operating Loss carryforwards and other tax attributes is not material as most of the carryforwards to which this ownership change applies already have been significantly limited by previous ownership changes occurring in 2011 and 2013.

8. Shareholders’ Deficit

The following reflects the activity in the shares of our common stock for the three months ended March 31, 2015:

| (shares in thousands) | 2015 |
|---|---|
| Beginning balance | 30,667 |
| Issuance of equity awards | 260 |
| Issuance of common stock upon conversion or exchange of Series B Notes | 995 |
| Ending balance | 31,922 |

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9. Stock Compensation Plans

Performance Based Awards

On March 9, 2015, the Company granted performance stock unit awards ("2015 Performance Awards") to employees. The awards provide a target number of shares that vest equally over three years, with the first vesting occurring on February 23, 2016. In addition to meeting service conditions, the number of performance stock units to be received depends on the attainment of defined Company-wide performance goals for 2015 based on adjusted return on invested capital over a one year performance period. The number of performance stock units ultimately earned will range between zero to 200% of the target award.

A summary of performance based unvested stock unit activity at target is as follows:

| (stock units in thousands) | Target Number of Units[a] | Weighted Average Fair Value |
|---|---|---|
| Unvested performance stock unit awards, at December 31, 2014 | — | — |
| 2015 Performance Awards granted | 203 | $18.23 |
| 2015 Performance Awards forfeited | — | — |
| Unvested performance stock unit awards, at March 31, 2015 | 203 | $18.23 |

[a] For the 2015 Performance Awards, participants in the aggregate can earn up to a maximum of 406 thousand performance stock units.

The Company expenses the grant date fair value of the awards which are probable of being earned over their performance period. Compensation cost on performance based awards was $0.3 million for the three months ended March 31, 2015. As of March 31, 2015, at target performance, $3.5 million of unrecognized compensation cost related to performance based awards is expected to be recognized over a weighted-average period of 2.9 years.

10. Earnings (Loss) Per Share

Given our net loss position for the three months ended March 31, 2015 and March 31, 2014, there were no dilutive securities for these periods. Our anti-dilutive securities for the three months ended March 31 are as follows:

| (shares, options and stock units in thousands) | 2015 | 2014 |
|---|---|---|
| Anti-dilutive shares, options, and stock units | 1,154 | 714 |
| Anti-dilutive Series A Notes | — | 2,675 |
| Anti-dilutive Series B Notes | — | 982 |

11. Business Segments

We report financial and descriptive information about our reporting segments on a basis consistent with that used internally for evaluating segment performance and allocating resources to segments. We evaluate segment performance primarily on external revenue and operating income (loss).

We have the following reportable segments, which are strategic business units that offer complementary transportation services to our customers:

- YRC Freight is the reporting segment for our transportation service providers focused on business opportunities in national, regional and international services. YRC Freight provides for the movement of industrial, commercial and retail goods, primarily through centralized management and customer facing organizations. This unit includes our LTL subsidiary YRC Freight and YRC Reimer, a subsidiary located in Canada that specializes in shipments into, across and out of Canada. In addition to the United States and Canada, YRC Freight also serves parts of Mexico, Puerto Rico and Guam.
- Regional Transportation is the reporting segment for our transportation service providers focused on business opportunities in the regional and next-day delivery markets. The Regional Transportation companies each provide regional, next-day ground services in their respective regions through a network of facilities located across the United States, Canada, Mexico and Puerto Rico.

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We charge management fees and other corporate service fees to our reportable segments based on the direct benefits received or an overhead allocation basis. Corporate and other operating losses represent residual operating expenses of the holding company. Corporate identifiable assets primarily consist of cash, cash equivalents, an investment in an equity method affiliate and deferred debt issuance costs. Intersegment revenue primarily relates to transportation services between our segments.

The following table summarizes our operations by business segment:

| (in millions) | YRC Freight | Regional Transportation | Corporate/ Eliminations | Consolidated |
|---|---|---|---|---|
| As of March 31, 2015 | | | | |
| Identifiable assets | $1,483.0 | $783.5 | $(300.3) | $1,966.2 |
| As of December 31, 2014 | | | | |
| Identifiable assets | $1,462.1 | $685.7 | $(162.8) | $1,985.0 |
| Three Months Ended March 31, 2015 | | | | |
| External revenue | $737.6 | $448.8 | $— | $1,186.4 |
| Operating income (loss) | $0.2 | $4.6 | $(1.1) | $3.7 |
| Three Months Ended March 31, 2014 | | | | |
| External revenue | $756.8 | $454.1 | $— | $1,210.9 |
| Operating income (loss) | $(32.5) | $7.9 | $(7.8) | $(32.4) |

12. Commitments, Contingencies and Uncertainties

Bryant Holdings Securities Litigation

On February 7, 2011, a putative class action was filed by Bryant Holdings LLC in the U.S. District Court for the District of Kansas on behalf of purchasers of our common stock between April 24, 2008 and November 2, 2009, inclusive (the “Class Period”), seeking damages under the federal securities laws for statements and/or omissions allegedly made by us and the individual defendants during the Class Period which plaintiffs claimed to be false and misleading.

The individual defendants are former officers of our Company. No current officers or directors are named in the lawsuit. The parties participated in voluntary mediation between March 11, 2013 and April 15, 2013. The mediation resulted in the execution of a mutually acceptable settlement agreement by the parties. Substantially all of the payments contemplated by the settlement would be covered by our liability insurance. The self-insured retention on this matter has been accrued.

The settlement agreement required court approval. On August 19, 2013, November 18, 2013, and February 11, 2015, the district court denied Plaintiffs’ motions for preliminary approval of the settlement. On March 4, 2015, the district court set the case for trial beginning June 6, 2016. On March 20, 2015, Plaintiffs filed a Petition for Writ of Mandamus in the United States Court of Appeals for the Tenth Circuit, seeking an order requiring the district court to vacate the trial setting and to give further consideration to the settlement agreement. On April 28, 2015, the Court of Appeals denied plaintiffs’ petition for mandamus.

Other Legal Matters

We are involved in other litigation or proceedings that arise in ordinary business activities. When possible, we insure against these risks to the extent we deem prudent, but no assurance can be given that the nature or amount of such insurance will be sufficient to fully indemnify us against liabilities arising out of pending and future legal proceedings. Many of these insurance policies contain self-insured retentions in amounts we deem prudent. Based on our current assessment of information available as of the date of these financial statements, we believe that our financial statements include adequate provisions for estimated costs and losses that may be incurred within the litigation and proceedings to which we are a party.

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

Cautionary Note Regarding Forward-Looking Statements

Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) should be read in conjunction with the Consolidated Financial Statements and the Notes to Consolidated Financial Statements included elsewhere in this report. MD&A and certain Notes to the Consolidated Financial Statements include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (“Exchange Act”). Forward-looking statements include those preceded by, followed by or characterized by words such as “will,” “expect,” “intend,” “anticipate,” “believe,” “project,” “forecast,” “pr “plan,” “designed,” “estimate,” “enable” and similar expressions. Forward-looking statements are inherently uncertain and are subject to significant business, economic, competitive, regulatory and other risks, uncertainties and contingencies, known and unknown, many of which are beyond our control. Readers are cautioned not to place undue reliance on any forward-looking statements. Our future financial condition and results could differ materially from those predicted in such forward-looking statements because of a number of factors, including (without limitation):

- our ability to generate sufficient liquidity to satisfy our cash needs and future cash commitments, including (without limitation) our obligations related to our indebtedness and lease and pension funding requirements, and our ability to achieve increased cash flows through improvement in operations;
- the pace of recovery in the overall economy, including (without limitation) customer demand in the retail and manufacturing sectors;
- the success of our management team in implementing its strategic plan and operational and productivity improvements, including (without limitation) our continued ability to meet high on-time and quality delivery performance standards and our ability to increase volume and yield, and the impact of those improvements on our future liquidity and profitability;
- our ability to comply with scheduled increases in financial performance-related debt covenants;
- our ability to finance the maintenance, acquisition and replacement of revenue equipment and other necessary capital expenditures;
- our dependence on our information technology systems in our network operations and the production of accurate information, and the risk of system failure, inadequacy or security breach;
- changes in equity and debt markets;
- inclement weather;
- price of fuel;
- sudden changes in the cost of fuel or the index upon which we base our fuel surcharge and the effectiveness of our fuel surcharge program in protecting us against fuel price volatility;
- competition and competitive pressure on pricing;
- expense volatility, including (without limitation) volatility due to changes in purchased transportation service or pricing for purchased transportation;
- our ability to comply and the cost of compliance with federal, state, local and foreign laws and regulations, including (without limitation) laws and regulations for the protection of employee safety and health (including new hours-of-service regulations) and the environment;
- terrorist attack;
- labor relations, including (without limitation) our ability to attract and retain qualified drivers, the continued support of our union employees for our strategic plan, the impact of work rules, work stoppages, strikes or other disruptions, our obligations to multi-employer health, welfare and pension plans, wage requirements and employee satisfaction;
- the impact of claims and litigation to which we are or may become exposed; and
- other risks and contingencies, including (without limitation) the risk factors that are included in our reports filed with the SEC, including those described under “Risk Factors” in our annual report on Form 10-K and quarterly reports on Form 10-Q, including this quarterly report.

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Overview

MD&A includes the following sections:

- Our Business — a brief description of our business and a discussion of how we assess our operating results.
- Consolidated Results of Operations — an analysis of our consolidated results of operations for the three months ended March 31, 2015 and 2014.
- Reporting Segment Results of Operations — an analysis of our results of operations for the three months ended March 31, 2015 and 2014 for our YRC Freight and Regional Transportation reporting segments.
- Certain Non-GAAP Financial Measures — an analysis of selected non-GAAP financial measures for the three months ended March 31, 2015 and 2014.
- Financial Condition/Liquidity and Capital Resources — a discussion of our major sources and uses of cash and an analysis of our cash flows and aggregate contractual obligations and commercial commitments.

The "first quarter" of the years discussed below refer to the three months ended March 31, respectively.

Our Business

We are a holding company that, through wholly owned operating subsidiaries and our interest in a Chinese joint venture, offers our customers a wide range of transportation services. We have one of the largest, most comprehensive less-than-truckload ("LTL") networks in North America with local, regional, national and international capabilities. Through our team of experienced service professionals, we offer industry-leading expertise in LTL shipments and flexible supply chain solutions, ensuring customers can ship industrial, commercial and retail goods with confidence.

We measure the performance of our business on both a consolidated basis and a reporting segment basis. We use several performance metrics, but rely primarily upon (without limitation) operating revenue, operating income (loss), and operating ratio. We also use certain non-GAAP financial measures as secondary measures to assess our operating performance.

- Operating Revenue: Our operating revenue has two primary components: volume (commonly evaluated using number of shipments and weight per shipment) and yield or price (commonly evaluated on a dollar per hundred weight basis and a dollar per shipment basis). Yield includes fuel surcharge revenue, which is common in the trucking industry and represents an amount charged to customers that adjusts with changing fuel prices. We base our fuel surcharges on a published national index and adjust them weekly. Rapid material changes in the index or our cost of fuel can positively or negatively impact our revenue and operating income versus prior periods, as there is a lag in our adjustment of base rates in response to changes in fuel surcharge. We believe that fuel surcharge is an accepted and important component of the overall pricing of our services to our customers. Without an industry accepted fuel surcharge program, our base pricing for our transportation services would require numerous changes. We believe the distinction between base rates and fuel surcharge has blurred over time, and it is impractical to clearly separate all the different factors that influence the price that our customers are willing to pay. In general, under our present fuel surcharge program, we believe rising fuel costs are beneficial to us and falling fuel costs are detrimental to us in the short term.

- Operating Income (Loss): Operating income (loss) is our operating revenue less operating expenses. Our consolidated operating income (loss) includes certain corporate charges that are not allocated to our YRC Freight and Regional Transportation reporting segments.

- Operating Ratio: Operating ratio is a common operating performance metric used in the trucking industry. It is calculated as (i) 100 percent (ii) minus the result of dividing operating income by operating revenue or (iii) plus the result of dividing operating loss by operating revenue, and expressed as a percentage.

- Non-GAAP Financial Measures: We use certain non-GAAP financial measures to assess our performance. These include (without limitation) EBITDA and adjusted EBITDA:

EBITDA: a non-GAAP measure that reflects our earnings before interest, taxes, depreciation, and amortization expense. EBITDA is used for internal management purposes as a financial measure that reflects our core operating performance.

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Adjusted EBITDA: a non-GAAP measure that reflects our earnings before interest, taxes, depreciation, and amortization expense, and further adjusts for letter of credit fees, equity-based compensation expense, net gains or losses on property disposals and certain other items, including restructuring professional fees, nonrecurring consulting fees, expenses associated with certain lump sum payments to our IBT employees and the results of permitted dispositions, discontinued operations, among other items, as defined in our credit facilities. Adjusted EBITDA is used for internal management purposes as a financial measure that reflects our core operating performance and to measure compliance with financial covenants in our credit facilities.

Our non-GAAP financial measures have the following limitations:
EBITDA does not reflect the interest expense or the cash requirements necessary to service interest or fund principal payments on our outstanding debt;
Adjusted EBITDA does not reflect the interest expense or the cash requirements necessary to fund restructuring professional fees, nonrecurring consulting fees, letter of credit fees, service interest, principal payments on our outstanding debt or lump sum payments to our IBT employees required under the modified labor agreement;
Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future and EBITDA and adjusted EBITDA do not reflect any cash requirements for such replacements;
Equity-based compensation is an element of our long-term incentive compensation package, although adjusted EBITDA excludes employee equity-based compensation expense when presenting our ongoing operating performance for a particular period;
Other companies in our industry may calculate adjusted EBITDA differently than we do, potentially limiting their usefulness as comparative measures.

Because of these limitations, our non-GAAP measures should not be considered a substitute for performance measures calculated in accordance with GAAP. We compensate for these limitations by relying primarily on our GAAP results and use our non-GAAP measures as secondary measures.

Consolidated Results of Operations

Our consolidated results include the consolidated results of our YRC Freight and Regional Transportation reporting segments as well as any unallocated corporate charges. A more detailed discussion of the operating results of our segments is presented in the “Reporting Segment Results of Operations” section below.

The table below provides summary consolidated financial information for the first quarter of 2015 and 2014:

| | First Quarter | | |
|---|---|---|---|
| (in millions) | 2015 | 2014 | Percent Change |
| Operating revenue | $1,186.4 | $1,210.9 | (2.0)% |
| Operating income (loss) | $3.7 | $(32.4) | 111.4% |
| Nonoperating expenses, net | $23.9 | $41.9 | 43.0% |
| Net loss | $(21.6) | $(70.2) | 69.2% |

First Quarter of 2015 Compared to the First Quarter of 2014

Our consolidated operating revenue decreased 2.0% during the first quarter of 2015 compared to the same period in 2014. The decrease in revenue is primarily attributed to strategic declines in volumes at YRC Freight, as our focus has been on yield improvement over tonnage growth and a reduction in our fuel surcharge revenue. Offsetting this decrease was increased yield over the comparable prior year period, which was largely driven by our commitment to maintain and grow yield and a stronger pricing environment.

Operating expenses for the first quarter of 2015 decreased $60.6 million, or 4.9%, compared to the same period in 2014. The decrease in operating expenses was driven by a $55.5 million, or 19.6%, decrease in operating expenses and supplies and an $18.4 million, or 2.5%, decrease in salaries, wages and employee benefits, partially offset by a $10.1 million, or 16.6%, increase in other operating expenses.

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- The $55.5 million, or 19.6%, decrease in operating expenses and supplies in the first quarter of 2015 was primarily the result of a $60.9 million decrease in fuel expense compared to the first quarter of 2014. This decrease was largely driven by lower fuel prices on a per gallon basis, as well as fewer miles driven. This decrease in fuel prices also decreased our revenue as discussed above.
- The $18.4 million, or 2.5%, decrease in salaries, wages and employee benefits was largely driven by lower total shipments in 2015 compared to 2014, which required less employee hours to process freight.
- The $10.1 million, or 16.6%, increase in other operating expenses was primarily driven by an $8.4 million increase in our bodily injury and property damage claim expense as a result of unfavorable development of our outstanding claims.

Nonoperating expenses decreased $18.0 million in the first quarter of 2015 compared to the first quarter of 2014. In the first quarter of 2014, we incurred additional interest expense that was driven by the acceleration of the amortization of the deferred debt costs on our then-existing Term Loan and then-existing ABL Facility when they were extinguished in the first quarter of 2014. The increase in interest expense was partially offset by the gain we recorded on the extinguishment of debt of $11.2 million in the first quarter of 2014, $16.3 million of which related to the acceleration of net premiums on our old debt, partially offset by $5.1 million of additional expense related to the fair value of the incremental shares provided to those Series B Note holders who exchanged their outstanding balances at a conversion price of $15.00 per share.

Our effective tax rate for the first quarter of 2015 and 2014 was (6.9)% and 5.5%, respectively. Significant items impacting the first quarter of 2015 rate include a net state and foreign tax provision, certain permanent items, and a change in the valuation allowance established for the net deferred tax asset balance projected for December 31, 2015. We recognize valuation allowances on deferred tax assets if, based on the weight of the evidence, we determine it is more likely than not that such assets will not be realized. Changes in valuation allowances are included in our tax provision in the period of change. In determining whether a valuation allowance is warranted, we evaluate factors such as prior years’ earnings history, expected future earnings, loss carry-back and carry-forward periods, reversals of existing deferred tax liabilities and tax planning strategies that potentially enhance the likelihood of the realization of a deferred tax asset. At March 31, 2015 and December 31, 2014, substantially all of our net deferred tax assets are subject to a valuation allowance.

Reporting Segment Results of Operations

We evaluate our operating performance using our YRC Freight and Regional Transportation reporting segments:

- YRC Freight is the reporting segment for our transportation service providers focused on business opportunities in national, regional and international services. YRC Freight provides for the movement of industrial, commercial and retail goods, primarily through centralized management and customer facing organizations. This unit includes our LTL subsidiary YRC Freight and YRC Reimer, a subsidiary located in Canada that specializes in shipments into, across and out of Canada. In addition to the United States and Canada, YRC Freight also serves parts of Mexico, Puerto Rico and Guam.
- Regional Transportation is the reporting segment for our transportation service providers focused on business opportunities in the regional and next-day delivery markets. The Regional Transportation companies each provide regional, next-day ground services in their respective regions through a network of facilities located across the United States, Canada, Mexico and Puerto Rico.

YRC Freight Results

YRC Freight represented 62% of consolidated operating revenue for both the first quarter of 2015 and 2014. The table below provides summary financial information for YRC Freight for the first quarter of 2015 and 2014:

| | First Quarter | | |
|---|---|---|---|
| (in millions) | 2015 | 2014 | Percent Change |
| Operating revenue | $737.6 | $756.8 | (2.5)% |
| Operating income (loss) | $0.2 | $(32.5) | 100.6% |
| Operating ratio[(a)] | 100.0% | 104.3% | 4.3 pp |

(a) pp represents the change in percentage points

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First Quarter of 2015 Compared to the First Quarter of 2014

YRC Freight reported operating revenue of $737.6 million in the first quarter of 2015, a decrease of $19.2 million, or 2.5%, compared to the same period in 2014. The table below summarizes the key revenue metrics for the YRC Freight reporting segment for the first quarter of 2015 compared to the first quarter of 2014:

| | First Quarter | | |
|---|---|---|---|
| | 2015 | 2014 | Percent Change[b] |
| Workdays | 62.5 | 63.0 | |
| Total picked up revenue (in millions) [a] | $737.4 | $755.9 | (2.5)% |
| Total tonnage (in thousands) | 1,566 | 1,646 | (4.9)% |
| Total tonnage per day (in thousands) | 25.05 | 26.13 | (4.1)% |
| Total shipments (in thousands) | 2,604 | 2,772 | (6.1)% |
| Total shipments per day (in thousands) | 41.66 | 44.00 | (5.3)% |
| Total picked up revenue per hundred weight | $23.55 | $22.96 | 2.6% |
| Total picked up revenue per hundred weight (excluding fuel surcharge) | $20.66 | $19.09 | 8.2% |
| Total picked up revenue per shipment | $283 | $273 | 3.8% |
| Total picked up revenue per shipment (excluding fuel surcharge) | $249 | $227 | 9.6% |
| Total weight per shipment (in pounds) | 1,203 | 1,188 | 1.3% |

| | First Quarter | |
|---|---|---|
| (in millions) | 2015 | 2014 |
| [a] Reconciliation of operating revenue to total picked up revenue: | | |
| Operating revenue | $737.6 | $756.8 |
| Change in revenue deferral and other | (0.2) | (0.9) |
| Total picked up revenue | $737.4 | $755.9 |

(a) Does not equal financial statement revenue due to revenue recognition adjustments between accounting periods.
(b) Percent change based on unrounded figures and not the rounded figures presented.

The increases in yield are primarily attributable to our commitment to maintain and grow yield and a stronger overall pricing environment. The decrease in volumes were primarily driven by a strategic decision to prioritize yield improvements over tonnage growth.

Operating income for YRC Freight was $0.2 million in the first quarter of 2015 compared to an operating loss of $32.5 million in the same period in 2014. Operating revenue in the first quarter of 2015 was lower by $19.2 million while total operating expenses decreased by $51.9 million, or 6.6%. The decrease in operating expense consisted primarily of a $36.2 million, or 20.6%, decrease in operating expenses and supplies and a $14.2 million, or 3.2%, decrease in salaries, wages and employees' benefits.

- The $36.2 million, or 20.6%, decrease in operating expenses and supplies in the first quarter of 2015 was primarily the result of a $36.8 million decrease in fuel expense compared to the first quarter of 2014. This decrease was largely driven by lower fuel prices on a per gallon basis and fewer miles driven. This decrease in fuel prices also decreased the revenue we recognized as a result of our fuel surcharge program and, therefore, this expense decrease was offset. Additionally, we received a $4.1 million legal settlement in the first quarter of 2015 that contributed to this decrease, which was partially offset by an increase in professional services largely driven by a $2.9 million nonrecurring consulting fee.

- The $14.2 million, or 3.2%, decrease in salaries, wages and employee benefits was largely driven by lower total shipments in 2015 compared to 2014, which required less employee hours to process freight.

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Regional Transportation Results

Regional Transportation represented 38% of consolidated revenue in the both the first quarter of 2015 and 2014. The table below provides summary financial information for Regional Transportation for the first quarter of 2015 and 2014:

| | First Quarter | | |
|---|---|---|---|
| (in millions) | 2015 | 2014 | Percent Change |
| Operating revenue | $448.8 | $454.1 | (1.2)% |
| Operating income | $4.6 | $7.9 | (41.8)% |
| Operating ratio [(a)] | 99.0 % | 98.3 % | (0.7 ) pp |

(a) pp represents the change in percentage points

First Quarter of 2015 Compared to the First Quarter of 2014

Regional Transportation reported operating revenue of $448.8 million for the first quarter of 2015, a decrease of $5.3 million, or 1.2%, from the first quarter of 2014. The table below summarizes the key revenue metrics for the Regional Transportation reporting segment for the first quarter of 2015 compared to the first quarter of 2014:

| | First Quarter | | |
|---|---|---|---|
| | 2015 | 2014 | Percent Change[(b)] |
| Workdays | 64.5 | 67.0 | |
| Total picked up revenue (in millions)[(a)] | $449.1 | $454.4 | (1.2 )% |
| Total tonnage (in thousands) | 1,976 | 2,015 | (1.9 )% |
| Total tonnage per day (in thousands) | 30.64 | 30.08 | 1.9 % |
| Total shipments (in thousands) | 2,617 | 2,706 | (3.3 )% |
| Total shipments per day (in thousands) | 40.58 | 40.38 | 0.5 % |
| Total picked up revenue per hundred weight | $11.36 | $11.28 | 0.8 % |
| Total picked up revenue per hundred weight (excluding fuel surcharge) | $10.03 | $9.48 | 5.8 % |
| Total picked up revenue per shipment | $172 | $168 | 2.1 % |
| Total picked up revenue per shipment (excluding fuel surcharge) | $151 | $141 | 7.3 % |
| Total weight per shipment (in pounds) | 1,510 | 1,490 | 1.4 % |

| | First Quarter | |
|---|---|---|
| (in millions) | 2015 | 2014 |
| [(a)] Reconciliation of operating revenue to total picked up revenue: | | |
| Operating revenue | $448.8 | $454.1 |
| Change in revenue deferral and other | 0.3 | 0.3 |
| Total picked up revenue | $449.1 | $454.4 |

(a) Does not equal financial statement revenue due to revenue recognition adjustments between accounting periods.
(b) Percent change based on unrounded figures and not the rounded figures presented.

The increases in yield are primarily attributable to our disciplined focus to grow yield during the quarter and a stronger overall pricing environment.

Operating income for Regional Transportation was $4.6 million for the first quarter of 2015, a decrease of $3.3 million from the same period in 2014. Operating revenue in the first quarter of 2015 was lower by $5.3 million, while total operating expenses decreased by $2.0 million, or 0.4%. The decrease in total operating expenses was primarily driven by a $19.4 million, or 16.9%, decrease in operating expenses and supplies, partially offset by a $5.4 million, or 21.4%, increase in other operating expenses, a

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$5.3 million, or 21.7%, increase in purchased transportation, and a $4.2 million, or 1.6%, increase in salaries, wages and employee benefits.

- The $19.4 million, or 16.9%, decrease in operating expenses and supplies in the first quarter of 2015 was primarily driven by a $24.1 million decrease in fuel expense compared to the first quarter of 2014. This decrease was largely driven by lower fuel prices on a per gallon basis. This decrease in fuel prices also decreased the revenue we recognized as a result of our fuel surcharge program and, therefore, this expense decrease was offset. The lower fuel costs were partially offset by a $3.7 million increase in vehicle maintenance primarily used to support our aging fleet.
- The $5.4 million, or 21.4%, increase in other operating expense in the first quarter of 2015 was primarily the result of a $5.7 million increase in our prior year bodily injury and property damage claim expense, as a result of unfavorable claim development on prior year claims.
- The $5.3 million, or 21.7%, increase in purchased transportation was primarily driven by a $5.4 million increase in vehicle rent expense as our percentage of leased units has increased from prior year due to our strategy of using operating leases to acquire new revenue equipment.
- The $4.2 million, or 1.6%, increase in in the first quarter of 2015 was primarily the result of a $2.0 million increase in workers' compensation expense, which was caused, in large part, by unfavorable claim development on prior year claims.

Certain Non-GAAP Financial Measures

As discussed in the "Our Business" section, we use certain non-GAAP financial measures to assess performance. These measures should be considered in addition to the results prepared in accordance with GAAP, but should not be considered a substitute for, or superior to, our GAAP financial measures. For segment adjusted EBITDA, we present the reconciliation from operating income (loss) to EBITDA and EBITDA to adjusted EBITDA as it is consistent with how we measure performance.

Consolidated Adjusted EBITDA

The reconciliation of net loss to EBITDA and EBITDA to Adjusted EBITDA (defined in our Term Loan credit agreement as "Consolidated EBITDA") for the first quarter of 2015 and 2014, and the trailing twelve months ended March 31, 2015, is as follows:

| | First Quarter | | Four Consecutive Quarters Ending |
|---|---|---|---|
| (in millions) | 2015 | 2014 | March 31, 2015 |
| Reconciliation of net loss to adjusted EBITDA: | | | |
| Net loss | $(21.6) | $(70.2) | $(19.1) |
| Interest expense, net | 27.4 | 58.1 | 118.7 |
| Income tax expense (benefit) | 1.4 | (4.1) | (10.6) |
| Depreciation and amortization | 41.6 | 41.0 | 164.2 |
| EBITDA | 48.8 | 24.8 | 253.2 |
| Adjustments for debt covenants: | | | |
| (Gains) losses on property disposals, net | 1.3 | 0.2 | (10.8) |
| Letter of credit expense | 2.2 | 5.2 | 9.1 |
| Restructuring professional fees | — | 1.1 | 3.1 |

| | | | |
|---|---|---|---|
| Nonrecurring consulting fees | 2.9 | — | 2.9 |
| Permitted dispositions and other | 0.2 | 0.1 | 1.8 |
| Equity based compensation expense | 0.5 | 6.6 | 8.2 |
| Amortization of ratification bonus | 5.2 | — | 20.8 |
| (Gain) loss on extinguishment of debt | 0.6 | (11.2) | 0.6 |
| Other, net[a] | (2.9) | (3.9) | (8.5) |
| Adjusted EBITDA | $58.8 | $22.9 | $280.4 |

[a] As required under our Term Loan Agreement, other, net, shown above consists of the impact of certain items to be included in Adjusted EBITDA under our Term Loan Agreement.

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Segment Adjusted EBITDA

The following represents Adjusted EBITDA by segment for the first quarter of 2015 and 2014:

| | First Quarter | |
|---|---|---|
| (in millions) | 2015 | 2014 |
| Adjusted EBITDA by segment: | | |
| YRC Freight | $32.1 | $(3.7) |
| Regional Transportation | 26.2 | 25.9 |
| Corporate and other | 0.5 | 0.7 |
| Adjusted EBITDA | $58.8 | $22.9 |

The reconciliation of operating income (loss), by segment, to EBITDA and EBITDA to Adjusted EBITDA for the first quarter of 2015 and 2014 is as follows:

| | First Quarter | |
|---|---|---|
| YRC Freight segment (in millions) | 2015 | 2014 |
| Reconciliation of operating income (loss) to adjusted EBITDA: | | |
| Operating income (loss) | $0.2 | $(32.5) |
| Depreciation and amortization | 23.9 | 24.7 |
| EBITDA | 24.1 | (7.8) |
| Adjustments for debt covenants: | | |
| Gains on property disposals, net | (0.2) | (0.2) |
| Letter of credit expense | 1.5 | 3.6 |
| Nonrecurring consulting fees | 2.9 | — |
| Amortization of ratification bonus | 3.3 | — |
| Other nonoperating expenses, net[a] | 0.5 | 0.7 |
| Adjusted EBITDA | $32.1 | $(3.7) |

[a] As required under our Term Loan, other nonoperating, net, shown above does not include the impact of non-cash foreign currency gains or losses.

| | First Quarter | |
|---|---|---|
| Regional Transportation segment (in millions) | 2015 | 2014 |
| Reconciliation of operating income to adjusted EBITDA: | | |
| Operating income | $4.6 | $7.9 |
| Depreciation and amortization | 17.7 | 16.4 |
| EBITDA | 22.3 | 24.3 |
| Adjustments for debt covenants: | | |
| Losses on property disposals, net | 1.5 | 0.4 |
| Letter of credit expense | 0.5 | 1.2 |
| Amortization of ratification bonus | 1.9 | — |
| Adjusted EBITDA | $26.2 | $25.9 |

| Corporate and other segment (in millions) | First Quarter 2015 | 2014 |
|---|---|---|
| Reconciliation of operating loss to adjusted EBITDA: | | |
| Operating loss | $(1.1 ) | $(7.8 |

Short-term borrowings

$
3,294,573

$
50,616

1.54
%

$
3,185,084

$
26,684

0.84
%

$
2,995,530

$
14,728

0.49
%
Medium-term notes

3,361,484

111,814

3.33

3,345,410

99,022

2.96

3,412,061

86,270

2.53

Collateral trust bonds

7,625,182

336,079

4.41

7,293,251

340,854

4.67

6,917,265

333,338

4.82

Guaranteed Underwriter Program notes payable

4,956,417

140,551

2.84

4,873,520

142,661

2.93

4,649,532

143,240

3.08

Farmer Mac notes payable

2,578,793

56,004

2.17

2,355,324

33,488

1.42

2,124,552

20,529

0.97

Other notes payable

33,742

1,509

4.47

39,314

1,780

4.53

44,621

2,051

4.60

Subordinated deferrable debt

742,336

37,661

5.07

742,203

37,657

5.07

435,488

21,245

4.88

Subordinated certificates

1,396,449

58,501

4.19

1,433,657

59,592

4.16

1,458,376

60,449

4.14

Total interest-bearing liabilities

$
23,988,976

$
792,735

3.30
%

$
23,267,763

$
741,738

3.19
%

$
22,037,425

$
681,850

3.09
%
Other liabilities

822,745

921,749

1,036,907

Total liabilities

24,811,721

24,189,512

23,074,332

Total equity

1,256,918

953,697

864,054

Total liabilities and equity

$
26,068,639

$
25,143,209

$

23,938,386

Net interest spread[4]

0.94
%

1.03
%

1.29
%
Impact of non-interest bearing funding[5]

0.18

0.17

0.14

Net interest income/net interest yield[6]

$
284,622

1.12
%

$
294,896

1.20
%

$
330,786

1.43
%

Adjusted net interest income/adjusted net interest yield:

Interest income

$
1,077,357

4.24
%

$
1,036,634

4.22

%

$
1,012,636

4.38
%
Interest expense

792,735

3.30

741,738

3.19

681,850

3.09

Add: Net accrued periodic derivative cash settlement[7]

74,281

0.69

84,478

0.80

88,758

0.89

Adjusted interest expense/adjusted average cost[8]

$
867,016

3.61
%

$
826,216

3.55
%

$
770,608

3.50
%
Adjusted net interest spread[4]

0.63
%

0.67

%

0.88
%
Impact of non-interest bearing funding

0.20

0.19

0.17

Adjusted net interest income/adjusted net interest yield(9)

$
210,341

0.83
%

$
210,418

0.86
%

$
242,028

1.05
%

30

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(1)Interest income on long-term, fixed-rate loans includes loan conversion fees, which are generally deferred and recognized as interest income using the effective interest method.
(2)Troubled debt restructuring ("TDR") loans.
(3)Consists of late payment fees and net amortization of deferred loan fees and loan origination costs.
(4)Net interest spread represents the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities. Adjusted net interest spread represents the difference between the average yield on total interest-earning assets and the adjusted average cost of total interest-bearing liabilities.
(5)Includes other liabilities and equity.
(6)Net interest yield is calculated based on net interest income for the period divided by total average interest-earning assets for the period.
(7)Represents the impact of net accrued periodic interest rate swap settlements during the period, which is added to interest expense to derive non-GAAP adjusted interest expense. The average (benefit)/cost associated with derivatives is calculated based on net accrued periodic interest rate swap settlements during the period divided by the average outstanding notional amount of derivatives during the period. The average outstanding notional amount of interest rate swaps was $10,816 million, $10,590 million and $9,993 million for fiscal year 2018, 2017 and 2016, respectively.
(8)Adjusted interest expense represents interest expense plus net accrued periodic interest rate swap settlements during the period. Net accrued periodic derivative cash settlements are reported on our consolidated statements of operations as a component of derivative gains (losses). Adjusted average cost is calculated based on adjusted interest expense for the period divided by total average interest-bearing liabilities during the period.
(9)Adjusted net interest yield is calculated based on adjusted net interest income for the period divided by total average interest-earning assets for the period.

Table 2 displays the change in net interest income between periods and the extent to which the variance is attributable to: (i) changes in the volume of our interest-earning assets and interest-bearing liabilities or (ii) changes in the interest rates of these assets and liabilities. The table also presents the change in adjusted net interest income between periods. Because of the numerous simultaneous volume and rate changes during any period, it is not possible to precisely allocate such changes between volume and rate. Changes that are not solely due to either volume or rate are allocated to these categories on a pro-rata basis based on the absolute value of the change due to average volume and average rate.

Table 2: Rate/Volume Analysis of Changes in Interest Income/Interest Expense

| | 2018 vs. 2017 | | | 2017 vs. 2016 | | |
|---|---|---|---|---|---|---|
| | Total | Variance due to:(1) | | Total | Variance due to:(1) | |
| (Dollars in thousands) | Variance | Volume | Rate | Variance | Volume | Rate |
| Interest income: | | | | | | |
| Long-term fixed-rate loans | $20,319 | $30,172 | $(9,853) | $20,472 | $53,775 | $(33,303) |
| Long-term variable-rate loans | 7,250 | 3,149 | 4,101 | 44 | 2,539 | (2,495) |
| Line of credit loans | 12,806 | 6,279 | 6,527 | 525 | 2,240 | (1,715) |
| Restructured loans | (16) | (92) | 76 | 393 | 55 | 338 |
| Nonperforming loans | — | — | — | (142) | (142) | — |
| Other income, net | (103) | — | (103) | 6 | — | 6 |
| Total loans | 40,256 | 39,508 | 748 | 21,298 | 58,467 | (37,169) |
| Cash, time deposits and investment securities | 467 | (3,425) | 3,892 | 2,700 | 1,286 | 1,414 |
| Interest income | $40,723 | $36,083 | $4,640 | $23,998 | $59,753 | $(35,755) |
| | | | | | | |
| Interest expense: | | | | | | |
| Short-term borrowings | $23,932 | $917 | $23,015 | $11,956 | $932 | $11,024 |
| Medium-term notes | 12,792 | 476 | 12,316 | 12,752 | (1,685) | 14,437 |
| Collateral trust bonds | (4,775) | 15,513 | (20,288) | 7,516 | 18,118 | (10,602) |
| Guaranteed Underwriter Program notes payable | (2,110) | 2,427 | (4,537) | (579) | 6,900 | (7,479) |
| Farmer Mac notes payable | 22,516 | 3,177 | 19,339 | 12,959 | 2,230 | 10,729 |
| Other notes payable | (271) | (252) | (19) | (271) | (244) | (27) |
| Subordinated deferrable debt | 4 | 7 | (3) | 16,412 | 14,963 | 1,449 |
| Subordinated certificates | (1,091) | (1,547) | 456 | (857) | (1,025) | 168 |
| Interest expense | 50,997 | 20,718 | 30,279 | 59,888 | 40,189 | 19,699 |
| Net interest income | $(10,274) | $15,365 | $(25,639) | $(35,890) | $19,564 | $(55,454) |
| | | | | | | |
| Adjusted net interest income: | | | | | | |
| Interest income | $40,723 | $36,083 | $4,640 | $23,998 | $59,753 | $(35,755) |
| Interest expense | 50,997 | 20,718 | 30,279 | 59,888 | 40,189 | 19,699 |
| Net accrued periodic derivative cash settlements(2) | (10,197) | 1,802 | (11,999) | (4,280) | 5,304 | (9,584) |
| Adjusted interest expense(3) | 40,800 | 22,520 | 18,280 | 55,608 | 45,493 | 10,115 |
| Adjusted net interest income | $(77) | $13,563 | $(13,640) | $(31,610) | $14,260 | $(45,870) |

———————————————

(1)The changes for each category of interest income and interest expense are divided between the portion of change attributable to the variance in volume and the portion of change attributable to the variance in rate for that category. The amount attributable to the combined impact of volume and rate has been allocated to each category based on the proportionate absolute dollar amount of change for that category.

(2)For net accrued periodic derivative cash settlements, the variance due to average volume represents the change in derivative cash settlements resulting from the change in the average notional amount of derivative contracts outstanding. The variance due to average rate represents the change in derivative cash settlements resulting from the net difference between the average rate paid and the average rate received for interest rate swaps during the period.

(3) See “Non-GAAP Financial Measures” for additional information on our adjusted non-GAAP measures.

Net interest income of $285 million for fiscal year 2018 decreased by $10 million, or 3%, from fiscal year 2017, driven by a decrease in the net interest yield of 7% (8 basis points) to 1.12%, which was partially offset by an increase in average interest-earning assets of 3%.

- Net Interest Yield: The decrease in the net interest yield in fiscal year 2018 was primarily due to an increase in our average cos cost of funds increased by 11 basis points to 3.30% for fiscal year 2018, largely due to increases in the cost of our short-term a (“LIBOR”) was 2.32% as of May 31, 2018, an increase of 111 basis points from May 31, 2017, while the federal funds target r points to 4.24%, largely due to increases in rates on variable rate loans and a higher yield on time deposits and investment secu

- Average Interest-Earning Assets: The increase in average interest-earning assets during fiscal year 2018 was primarily attributable to growth in average total loans of $1,077 million, or 5%, over the prior fiscal year, as members obtained advances to fund capital investments and refinanced with us loans made by other lenders.

Net interest income of $295 million in fiscal year 2017 decreased by $36 million, or 11%, from fiscal year 2016, driven by a decrease in the net interest yield of 16% (23 basis points) to 1.20%, which was partially offset by an increase in average interest-earning assets of 6%.

- Net Interest Yield: The decrease in the net interest yield in fiscal year 2017 reflected the combined impact of a decline in the average yield on interest-earning assets and an increase in our average cost of funds. The average yield on interest-earning assets decreased by 16 basis points to 4.22% in fiscal year 2017. The decrease resulted from repayments on existing long-term loans with higher weighted-average fixed rates than the weighted average fixed rates on new long-term loan advances, coupled with the repricing of higher-rate loans to lower fixed rates. Our average cost of funds increased by 10 basis points in fiscal year 2017 to 3.19%, largely due to an increase in short-term interest rates during the fiscal year.

- Average Interest-Earning Assets: The increase in average interest-earning assets during fiscal year 2017 was primarily attributable to growth in average total loans of $1,344 million, or 6%, over the prior fiscal year, as members obtained advances to fund capital investments and refinanced with us loans made by other lenders.

Adjusted net interest income of $210 million in fiscal year 2018 was flat compared to fiscal year 2017, as the decrease in the adjusted net interest yield of 3% (3 basis points) to 0.83% was offset by the increase in average interest-earning assets of 3%. The decrease in the adjusted net interest yield was driven by an increase in the adjusted average cost of funds of 6 basis points to 3.61%, attributable to the increase in short-term interest rates that resulted in a higher average cost for our short-term and variable-rate borrowings.

Adjusted net interest income of $210 million in fiscal year 2017 decreased by $32 million, or 13%, from fiscal year 2016, driven by a decrease in the adjusted net interest yield of 18% (19 basis points) to 0.86%, which was partially offset by the increase in average interest-earning assets of 6%. The decrease in the adjusted net interest yield was attributable to the combined impact of the decline in the average yield on interest-earning assets and an increase in our adjusted average cost of funds.

Our adjusted net interest income and adjusted net interest yield include the impact of net accrued periodic derivative cash settlements during the year. We recorded net periodic derivative cash settlement expense of $74 million in fiscal year 2018 compared with $84 million and $89 million in fiscal years 2017 and 2016, respectively. See “Non-GAAP Financial Measures” for additional information on our adjusted measures.

Provision for Loan Losses

Our provision for loan losses in each period is primarily driven by the level of allowance that we determine is necessary for probable incurred loan losses inherent in our loan portfolio as of each balance sheet date.

We recorded a benefit for loan losses of $18 million in fiscal year 2018, compared with a provision for loan losses of $6 million in fiscal year 2017 and a benefit for loan losses of $1 million in fiscal year 2016. The benefit for loan losses of $18 million in fiscal year 2018 was due to the $18 million reduction in our allowance for loan losses to $19 million as of May 31, 2018, from $37 million as of May 31, 2017. In the fourth quarter of fiscal year 2018, we increased the recovery rate

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assumptions used in determining the collective allowance for our electric distribution and power supply loan portfolios to reflect management's current assessment of expected losses in the event of default on a loan in these portfolios. In fiscal year 2018, for the fifth consecutive fiscal year, we had no payment defaults, charge-offs, delinquent loans or nonperforming loans in our electric utility loan portfolio. The increase in recovery rate assumptions was the primary driver of the $18 million reduction in our allowance for loan losses.

The unfavorable shift of $7 million in the provision for loan losses in fiscal year 2017 from the prior fiscal year was primarily attributable to an increase in total loans outstanding coupled with an increase in default rates for loans with higher risk, which was partially offset by a decrease in default rates for loans with lower risk and a reduction in the specific allowance for individually impaired loans.

For additional information on our allowance methodology and our allowance for loan losses, see "Critical Accounting Policies and Estimates" and "Credit Risk—Allowance for Loan Losses" of MD&A. Also refer to "Note 1—Summary of Significant Accounting Policies" and "Note 4—Loans" of this report.

Non-Interest Income

Non-interest income consists of fee and other income, gains and losses on derivatives not accounted for in hedge accounting
relationships and results of operations of foreclosed assets.

Table 3 presents the components of non-interest income recorded in our consolidated results of operations for fiscal years 2018, 2017 and 2016.

Table 3: Non-Interest Income

| | Year Ended May 31, | | |
|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2016 |
| Non-interest income: | | | |
| Fee and other income | $17,578 | $19,713 | $21,785 |
| Derivative gains (losses) | 231,721 | 94,903 | (309,841) |
| Results of operations of foreclosed assets | — | (1,749) | (6,899) |
| Total non-interest income | $249,299 | $112,867 | $(294,955) |

The significant variances in non-interest income between years were primarily attributable to changes in net derivative gains (losses) recognized in our consolidated statements of operations.

Derivative Gains (Losses)

Our derivative instruments are an integral part of our interest rate risk-management strategy. Our principal purpose in using derivatives is to manage our aggregate interest rate risk profile within prescribed risk parameters. The derivative instruments we use primarily include interest rate swaps, which we typically hold to maturity. In addition, we may on occasion use treasury locks to manage the interest rate risk associated with debt that is scheduled to reprice in the future. The primary factors affecting the fair value of our derivatives and derivative gains (losses) recorded in our results of operations include changes in interest rates, the shape of the swap curve and the composition of our derivative portfolio. We generally do not designate our interest rate swaps, which currently account for the substantial majority of our derivatives, for hedge accounting. Accordingly, changes in the fair value of interest rate swaps are reported in our consolidated statements of operations under derivative gains (losses). However, we typically designate treasury locks as cash flow hedges. We entered into one treasury lock agreement, which was designated as a cash flow hedge of a forecasted transaction, during fiscal year 2018. We did not have any derivatives designated as accounting hedges during fiscal year 2017 or 2016.

We currently use two types of interest rate swap agreements: (i) we pay a fixed rate and receive a variable rate (“pay-fixed swaps”); and (ii) we pay a variable rate and receive a fixed rate (“receive-fixed swaps”). The benchmark variable rate for the substantial majority of the floating-rate payments under our swap agreements is LIBOR. Table 4 displays the average notional amount outstanding, by swap agreement type, and the weighted-average interest rate paid and received for interest rate swap settlements during fiscal years 2018, 2017 and 2016. As indicated in Table 4, our interest rate swap portfolio currently consists of a higher proportion of pay-fixed swaps than receive-fixed swaps. The profile of our interest rate swap portfolio, however, may change as a result of changes in market conditions and actions taken to manage exposure to interest rate risk.

Table 4: Derivative Average Notional Amounts and Average Interest Rates

| | Year Ended May 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2018 | | | 2017 | | | 2016 | | |
| (Dollars in thousands) | Average Notional Balance | Weighted-Average Rate Paid | Weighted-Average Rate Received | Average Notional Balance | Weighted-Average Rate Paid | Weighted-Average Rate Received | Average Notional Balance | Weighted-Average Rate Paid | Weighted-Average Rate Received |
| Pay-fixed swaps | $7,007,207 | 2.82 % | 1.58 % | $6,675,617 | 2.89 % | 0.90 % | $6,322,338 | 3.03 % | 0.45 % |
| Receive-fixed swaps | 3,808,794 | 2.16 | 2.60 | 3,914,479 | 1.34 | 2.71 | 3,670,585 | 0.88 | 2.97 |
| Total | $10,816,001 | 2.58 % | 1.94 % | $10,590,096 | 2.32 % | 1.57 % | $9,992,923 | 2.24 % | 1.38 % |

The average remaining maturity of our pay-fixed and receive-fixed swaps was 19 years and five years, respectively, as of May 31, 2018. In comparison, the average remaining maturity of our pay-fixed and receive-fixed swaps was 19 years and four years, respectively, as of May 31, 2017 and 18 years and three years, respectively, as of May 31, 2016.

Pay-fixed swaps generally decrease in value as interest rates decline and increase in value as interest rates rise. In contrast, receive-fixed swaps generally increase in value as interest rates decline and decrease in value as interest rates rise. Because our pay-fixed and receive-fixed swaps are referenced to different maturity terms along the swap curve, different changes in the swap curve—parallel, flattening or steepening—will result in differences in the fair value of our derivatives. The chart below provides comparative swap curves as of May 31, 2018, 2017, 2016 and 2015.

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Benchmark rates obtained from Bloomberg.

Table 5 presents the components of net derivative gains (losses) recorded in our consolidated results of operations. Derivative cash settlements represent the net periodic contractual interest amount for our interest-rate swaps for the

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reporting period. Derivative forward value gains (losses) represent the change in fair value of our interest rate swaps during the reporting period due to changes in expected future interest rates over the remaining life of our derivative contracts.

Table 5: Derivative Gains (Losses)

| | Year Ended May 31, | | |
|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2016 |
| Derivative gains (losses) attributable to: | | | |
| Derivative cash settlements | $(74,281 ) | $(84,478) | $(88,758 ) |
| Derivative forward value gains (losses) | 306,002 | 179,381 | (221,083 ) |
| Derivative gains (losses) | $231,721 | $94,903 | $(309,841) |

The net derivative gains of $232 million in fiscal year 2018 were largely attributable to a net increase in the fair value of our pay-fixed swaps as interest rates increased across the swap curve, as depicted by the May 31, 2018 swap curve presented in the above chart. As depicted in the comparative swap curves, the general level of market interest rates as of the end of fiscal year 2018 was higher relative to the general level of market rates as of the end of fiscal year 2017, resulting in the recognition of significantly higher net derivative gain amounts.

The net derivative gains of $95 million in fiscal year 2017 were primarily attributable to a net increase in the fair value of our swaps due to an overall increase in interest rates across the swap curve, as depicted by the May 31, 2017 swap curve presented in the above chart.

The derivative losses of $310 million in fiscal year 2016 were primarily attributable to a net decrease in the fair value of our swaps due to a flattening of the swap curve resulting from an increase in short-term interest rates and a decline in long-term interest rates, as depicted by the comparative swap curves as of May 31, 2016 and 2015 in the above chart.

See “Note 1—Summary of Significant Accounting Policies—Derivative Instruments” and “Note 9—Derivative Instruments an Hedging Activities” for additional information on our derivative instruments. Also refer to “Note 13—Fair Value Measurement” for information on how we estimate the fair value of our derivative instruments.

Results of Operations of Foreclosed Assets

Results of operations of foreclosed assets consists of the operating results of entities controlled by CFC that hold foreclosed assets, impairment charges related to those entities, gains or losses related to the disposition of the assets and potential subsequent charges related to those assets. On July 1, 2016, we completed the sale of Caribbean Asset Holdings, LLC (“CAH”). As a result, we did not carry any foreclosed assets on our consolidated balance sheet as of May 31, 2018 and 2017.

We recorded charges of $2 million in fiscal year 2017 and $7 million in fiscal year 2016 related to foreclosed assets. The charge of $2 million in fiscal year 2017 represented the combined impact of adjustments recorded at the closing date of the sale of CAH, post-closing purchase price adjustments and certain legal costs incurred pertaining to CAH. The charge of $7 million in fiscal year 2016 was attributable to impairment of our investment in CAH due to a reduction in the fair value less estimated cost to sell.

In connection with the sale of CAH, $16 million of the sale proceeds was deposited into escrow to fund potential indemnification claims following the closing. Of this amount, $14.5 million was designated to cover general indemnification claims and has been released back to us. The remaining $1.5 million was designated to cover indemnification of certain tax liens and remains in escrow. We continue to be liable for certain indemnification obligations, if raised and substantiated, regardless of whether amounts are held in escrow.

Non-Interest Expense

Non-interest expense consists of salaries and employee benefit expense, general and administrative expenses, losses on early extinguishment of debt and other miscellaneous expenses.

Table 6 presents the components of non-interest expense recorded in our consolidated results of operations in fiscal years 2018, 2017 and 2016.

Table 6: Non-Interest Expense

| | Year Ended May 31, | | |
|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2016 |
| Non-interest expense: | | | |
| Salaries and employee benefits | $(51,422) | $(47,769) | $(44,590) |
| Other general and administrative expenses | (39,462 ) | (38,457 ) | (41,753 ) |
| Gains (losses) on early extinguishment of debt | — | 192 | (333 ) |
| Other non-interest expense | (1,943 ) | (1,948 ) | (1,260 ) |
| Total non-interest expense | $(92,827) | $(87,982) | $(87,936) |

Non-interest expense of $93 million for fiscal year 2018 increased by $5 million, or 6%, from fiscal year 2017, primarily due to an increase in salaries and employee benefits expenses. Non-interest expenses of $88 million in fiscal year 2017 was relatively unchanged from fiscal year 2016, as an increase in salaries and employee benefits expenses was largely offset by a decrease in other general and administrative expenses.

Net Income (Loss) Attributable to Noncontrolling Interests

Net income (loss) attributable to noncontrolling interests represents 100% of the results of operations of NCSC and RTFC, as the members of NCSC and RTFC own or control 100% of the interest in their respective companies. The fluctuations in net income (loss) attributable to noncontrolling interests are primarily due to changes in the fair value of NCSC's derivative instruments recognized in NCSC's earnings.

We recorded net income attributable to noncontrolling interests of $2 million in fiscal year 2018, compared with net income of $2 million in fiscal year 2017 and a net loss of $2 million in fiscal year 2016.

CONSOLIDATED BALANCE SHEET ANALYSIS

Total assets of $26,690 million as of May 31, 2018 increased by $1,485 million, or 6%, from May 31, 2017, primarily due to growth in our loan portfolio. Total liabilities of $25,184 million as of May 31, 2018 increased by $1,077 million, or 4%, from May 31, 2017, largely due to debt issuances to fund loan growth. Total equity increased by $407 million during fiscal year 2018 to $1,506 million as of May 31, 2018, attributable to our reported net income of $457 million, which was partially offset by patronage capital retirement of $45 million in September 2017.

Following is a discussion of changes in the major components of our assets and liabilities during fiscal year 2018. Period-end balance sheet amounts may vary from average balance sheet amounts due to liquidity and balance sheet management activities that are intended to manage liquidity requirements for the company and our customers, and our market risk exposure in accordance with our risk appetite.

Loan Portfolio

We offer long-term fixed- and variable-rate loans and line of credit variable-rate loans. The substantial majority of loans in our portfolio represent advances under secured long-term facilities with terms up to 35 years. Borrowers have the option of selecting a fixed or variable interest rate for each advance for periods ranging from one year to the final maturity of the facility. Line of credit loans are typically revolving facilities and are generally unsecured. We also offer a conversion option to members with long-term loan agreements, which allows borrowers to change the rate and term prior to the repricing date. Borrowers are generally charged a conversion fee when converting from a fixed to a variable rate, or a fixed rate to another fixed rate.

Loans Outstanding

Table 7 summarizes loans to members, by loan type and by member class, for the five-year period ended May 31, 2018. As indicated in Table 7, long-term fixed-rate loans accounted for 90% and 91% of loans to members as of May 31, 2018 and 2017, respectively.

Table 7: Loans Outstanding by Type and Member Class

| | May 31, | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| (Dollars in millions) | 2018 | | 2017 | | 2016 | | 2015 | | 2014 | |
| Loans by type: | Amount | % of Total | Amount | % of Total | Amount | % of Total | Amount | % of Total | Amount | % of Total |
| Long-term loans: | | | | | | | | | | |
| Fixed-rate | $22,696 | 90 % | $22,137 | 91 % | $21,391 | 93 % | $19,722 | 92 % | $18,360 | 89 % |
| Variable-rate | 1,040 | 4 | 847 | 3 | 757 | 3 | 699 | 3 | 772 | 4 |
| Total long-term loans | 23,736 | 94 | 22,984 | 94 | 22,148 | 96 | 20,421 | 95 | 19,132 | 93 |
| Lines of credit | 1,432 | 6 | 1,372 | 6 | 1,005 | 4 | 1,038 | 5 | 1,335 | 7 |
| Total loans outstanding | $25,168 | 100% | $24,356 | 100 % | $23,153 | 100% | $21,459 | 100% | $20,467 | 100% |
| Deferred loan origination costs | 11 | — | 11 | — | 10 | — | 10 | — | 10 | — |
| Loans to members | $25,179 | 100% | $24,367 | 100 % | $23,163 | 100% | $21,469 | 100% | $20,477 | 100% |
| | | | | | | | | | | |
| Loans by member class: | | | | | | | | | | |
| CFC: | | | | | | | | | | |
| Distribution | $19,552 | 78 % | $18,825 | 77 % | $17,674 | 77 % | $16,095 | 75 % | $15,035 | 74 % |
| Power supply | 4,397 | 18 | 4,505 | 19 | 4,401 | 19 | 4,181 | 20 | 4,086 | 20 |
| Statewide and associate | 70 | — | 58 | — | 55 | — | 65 | — | 68 | — |
| CFC total | 24,019 | 96 | 23,388 | 96 | 22,130 | 96 | 20,341 | 95 | 19,189 | 94 |
| NCSC | 786 | 3 | 614 | 3 | 681 | 3 | 732 | 3 | 828 | 4 |
| RTFC | 363 | 1 | 354 | 1 | 342 | 1 | 386 | 2 | 450 | 2 |
| Total loans outstanding | $25,168 | 100% | $24,356 | 100 % | $23,153 | 100% | $21,459 | 100% | $20,467 | 100% |
| Deferred loan origination costs | 11 | | 11 | | 10 | — | 10 | — | 10 | — |
| Loans to members | $25,179 | 100% | $24,367 | 100 % | $23,163 | 100% | $21,469 | 100% | $20,477 | 100% |

Loans to members totaled $25,179 million as of May 31, 2018, an increase of $812 million, or 3%, from May 31, 2017. The increase was primarily due to an increase in CFC distribution loans of $726 million, an increase in NCSC loans of
$173 million and an increase in RTFC loans of $9 million, which was partially offset by a decrease in CFC power supply loans of $107 million. Long-term loan advances totaled $2,203 million during fiscal year 2018, with approximately 67% of those advances for capital expenditures by members and 24% for the refinancing of loans made by other lenders.

We provide additional information on our loan product types in “Item 1. Business—Loan Programs” and “Note 4—Loans.” Se “Debt—Collateral Pledged” below for information on encumbered and unencumbered loans and “Credit Risk Management” for information on the credit risk profile of our loan portfolio.

Loan Retention Rate

Table 8 presents a comparison between the historical retention rate of CFC's long-term fixed-rate loans that repriced in accordance with our standard loan provisions, during the past three fiscal years and provides information on the percentage of loans that repriced to either another fixed-rate term or a variable rate. The retention rate is calculated based on the election made by the borrower at the repricing date. The average annual retention rate of CFC's repriced loans has been 98% over the last three fiscal years.

Table 8: Historical Retention Rate and Repricing Selection[(1)]

| | May 31, 2018 | | | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | Amount | % of Total | | Amount | % of Total | | Amount | % of Total | |
| Loans retained: | | | | | | | | | |
| Long-term fixed rate selected | $741,792 | 82 | % | $824,415 | 84 | % | $1,001,118 | 93 | % |
| Long-term variable rate selected | 157,539 | 17 | | 137,835 | 14 | | 54,796 | 5 | |
| Total loans retained by CFC | 899,331 | 99 | | 962,250 | 98 | | 1,055,914 | 98 | |
| Loans repaid[(2)] | 4,637 | 1 | | 25,076 | 2 | | 22,415 | 2 | |
| Total | $903,968 | 100 | % | $987,326 | 100 | % | $1,078,329 | 100 | % |

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(1) Does not include NCSC and RTFC loans.
(2) Includes loans totaling $1 million, $1 million and $4 million as of May 31, 2018, 2017 and 2016, respectively, that were converted to new loans at the repricing date and transferred to a third party as part of our direct loan sale program. See "Note 4—Loans" for information on our sale of loans.

Scheduled Loan Principal Payments

Table 9 displays scheduled long-term loan principal payments as of May 31, 2018, for each of the five fiscal years subsequent to May 31, 2018 and thereafter.

Table 9: Long-Term Loan Scheduled Principal Payments

| | Fixed Rate | | | Variable Rate | |
|---|---|---|---|---|---|
| (Dollars in thousands) | Scheduled Principal Payments | Weighted-Average Interest Rate | | Scheduled Principal Payments | Total Scheduled Principal Payments |
| Fiscal year: | | | | | |
| 2019 | $1,131,941 | 4.33 | % | $94,966 | $1,226,907 |
| 2020 | 1,168,011 | 4.40 | | 77,192 | 1,245,203 |
| 2021 | 1,168,748 | 4.43 | | 53,445 | 1,222,193 |
| 2022 | 1,148,220 | 4.48 | | 49,092 | 1,197,312 |
| 2023 | 1,157,297 | 4.54 | | 43,467 | 1,200,764 |
| Thereafter | 16,921,968 | 4.66 | | 721,329 | 17,643,297 |
| Total | $22,696,185 | 4.60 | | $1,039,491 | $23,735,676 |

Debt

We utilize both short-term borrowings and long-term debt as part of our funding strategy and asset/liability interest rate risk management. We seek to maintain diversified funding sources across products, programs and markets to manage funding concentrations and reduce our liquidity or debt rollover risk. Our funding sources include a variety of secured and unsecured debt securities in a wide range of maturities to our members and affiliates and in the capital markets.

Debt Product Types

We offer various short- and long-term unsecured debt securities to our members and affiliates, including commercial paper, select notes, daily liquidity fund notes, medium-term notes and subordinated certificates. We also issue commercial paper, medium-term notes and collateral trust bonds in the capital markets. Additionally, we have access to funds under borrowing arrangements with banks, private placements and U.S. government agencies. Table 10 displays our primary funding sources and their selected key attributes.

Table 10: Debt Product Types

| Debt Product Type: | Maturity Range | Market | Secured/Unsecured |
|---|---|---|---|
| Short-term funding programs: | | | |
| Commercial paper | 1 to 270 days | Capital markets, members and affiliates | Unsecured |
| Select notes | 30 to 270 days | Members and affiliates | Unsecured |
| Daily liquidity fund notes | Demand note | Members and affiliates | Unsecured |
| Other funding programs: | | | |
| Medium-term notes | 9 months to 30 years | Capital markets, members and affiliates | Unsecured |
| Collateral trust bonds(1) | Up to 30 years | Capital markets | Secured |
| Guaranteed Underwriter Program notes payable(2) | Up to 20 years | U.S. government | Secured |
| Farmer Mac notes payable(3) | Up to 30 years | Private placement | Secured |
| Other notes payable(4) | Up to 30 years | Private placement | Both |
| Subordinated deferrable debt(5) | Up to 30 years | Capital markets | Unsecured |
| Members' subordinated certificates(6) | Up to 100 years | Members | Unsecured |
| Revolving credit agreements | 3 to 5 years | Bank institutions | Unsecured |

(1) Collateral trust bonds are secured by the pledge of permitted investments and eligible mortgage notes from distribution system borrowers in an amount at least equal to the outstanding principal amount of collateral trust bonds.
(2) Represents notes payable under the Guaranteed Underwriter Program, which supports the Rural Economic Development Loan and Grant program. The Federal Financing Bank provides the financing for these notes, and RUS provides a guarantee of repayment. We are required to pledge eligible mortgage notes from distribution and power supply system borrowers in an amount at least equal to the outstanding principal amount of the notes payable.
(3) We are required to pledge eligible mortgage notes from distribution and power supply system borrowers in an amount at least equal to the outstanding principal amount under note purchase agreements with Farmer Mac.
(4) Other notes payable consist of unsecured and secured Clean Renewable Energy Bonds and unsecured notes payable issued by NCSC. We are required to pledge eligible mortgage notes from distribution and power supply system borrowers in an amount at least equal to the outstanding principal amount under the Clean Renewable Energy Bonds Series 2009A note purchase agreement.
(5) Subordinated deferrable debt is subordinate and junior to senior debt and debt obligations we guarantee, but senior to subordinated certificates. We have the right at any time, and from time to time, during the term of the subordinated deferrable debt to suspend interest payments for a maximum period of 20 consecutive quarters. To date, we have not exercised our option to suspend interest payments. We have the right to call the subordinated deferrable debt, at par, any time after 10 years.
(6) Members' subordinated certificates consist of membership subordinated certificates, loan and guarantee certificates and member capital securities, and are subordinated and junior to senior debt, subordinated debt and debt obligations we guarantee. Membership subordinated certificates generally mature 100 years subsequent to issuance. Loan and guarantee subordinated certificates have the same maturity as the related long-term loan. Some certificates also may amortize annually based on the outstanding loan balance. Member capital securities mature 30 years subsequent to

issuance. Member capital securities are callable at par beginning 10 years subsequent to the issuance and anytime thereafter.

Debt Outstanding

Table 11 displays the composition, by product type, of our outstanding debt and the weighted average interest rate as of May 31, 2018, 2017 and 2016. Table 11 also displays the composition of our debt based on several additional selected attributes.

Table 11: Total Debt Outstanding and Weighted-Average Interest Rates

| (Dollars in thousands) | May 31, 2018 Outstanding Amount | Weighted-Average Interest Rate | 2017 Outstanding Amount | Weighted-Average Interest Rate | 2016 Outstanding Amount | Weighted-Average Interest Rate |
|---|---|---|---|---|---|---|
| Debt product type: | | | | | | |
| Commercial paper: | | | | | | |
| Members, at par | $1,202,105 | 1.89 % | $928,158 | 0.95 % | $848,007 | 0.45 % |
| Dealer, net of discounts | 1,064,266 | 1.87 | 999,691 | 0.93 | 659,935 | 0.43 |
| Total commercial paper | 2,266,371 | 1.88 | 1,927,849 | 0.94 | 1,507,942 | 0.44 |
| Select notes to members | 780,472 | 2.04 | 696,889 | 1.12 | 701,849 | 0.62 |
| Daily liquidity fund notes to members | 400,635 | 1.50 | 527,990 | 0.80 | 525,959 | 0.34 |
| Medium-term notes: | | | | | | |
| Members, at par | 643,821 | 2.31 | 612,951 | 1.97 | 654,058 | 1.66 |
| Dealer, net of discounts | 3,002,979 | 3.51 | 2,364,671 | 3.48 | 2,648,369 | 3.02 |
| Total medium-term notes | 3,646,800 | 3.30 | 2,977,622 | 3.17 | 3,302,427 | 2.75 |
| Collateral trust bonds | 7,639,093 | 3.89 | 7,634,048 | 4.08 | 7,253,096 | 4.28 |
| Guaranteed Underwriter Program notes payable | 4,856,143 | 2.85 | 4,985,484 | 2.83 | 4,777,111 | 2.98 |
| Farmer Mac notes payable | 2,891,496 | 2.88 | 2,513,389 | 1.71 | 2,303,123 | 1.15 |
| Other notes payable | 29,860 | 3.42 | 35,223 | 3.55 | 40,944 | 3.61 |
| Subordinated deferrable debt | 742,410 | 4.98 | 742,274 | 4.98 | 742,212 | 4.98 |
| Members’ subordinated certificates: | | | | | | |
| Membership subordinated certificates | 630,448 | 4.94 | 630,098 | 4.94 | 630,063 | 4.94 |
| Loan and guarantee subordinated certificates | 528,386 | 2.93 | 567,830 | 3.02 | 593,701 | 2.99 |
| Member capital securities | 221,148 | 5.00 | 221,097 | 5.00 | 220,046 | 5.00 |
| Total members’ subordinated certificates | 1,379,982 | 4.18 | 1,419,025 | 4.18 | 1,443,810 | 4.14 |
| Total debt outstanding | $24,633,262 | 3.25 % | $23,459,793 | 3.07 % | $22,598,473 | 3.03 % |
| | | | | | | |
| Security type: | | | | | | |
| Unsecured debt | 37 % | | 35 % | | 37 % | |
| Secured debt | 63 | | 65 | | 63 | |
| Total | 100 % | | 100 % | | 100 % | |
| | | | | | | |
| Funding source: | | | | | | |
| Members | 18 % | | 18 % | | 18 % | |
| Private placement: | | | | | | |
| Guaranteed Underwriter Program notes payable | 20 | | 21 | | 21 | |
| Farmer Mac notes payable | 12 | | 11 | | 10 | |
| Other | — | | — | | 1 | |
| Total private placement | 32 | | 32 | | 32 | |
| Capital markets | 50 | | 50 | | 50 | |
| Total | 100 % | | 100 % | | 100 % | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Interest rate type: | | | | | | |
| Fixed-rate debt | 74 | % | 74 | % | 74 | % |
| Variable-rate debt | 26 | | 26 | | 26 | |
| Total | 100 | % | 100 | % | 100 | % |
| | | | | | | |
| Interest rate type including the impact of swaps: | | | | | | |
| Fixed-rate debt(1) | 87 | % | 87 | % | 88 | % |
| Variable-rate debt(2) | 13 | | 13 | | 12 | |
| Total | 100 | % | 100 | % | 100 | % |
| | | | | | | |
| Maturity classification:(3) | | | | | | |
| Short-term borrowings | 15 | % | 14 | % | 13 | % |
| Long-term and subordinated debt(4) | 85 | | 86 | | 87 | |
| Total | 100 | % | 100 | % | 100 | % |

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[1] Includes variable-rate debt that has been swapped to a fixed rate, net of any fixed-rate debt that has been swapped to a variable rate.
[2] Includes fixed-rate debt that has been swapped to a variable rate, net of any variable-rate debt that has been swapped to a fixed rate. Also includes commercial paper notes, which generally have maturities of less than 90 days. The interest rate on commercial paper notes does not change once the note has been issued; however, the interest rate for new commercial paper issuances changes daily.
[3] Borrowings with an original contractual maturity of one year or less are classified as short-term borrowings. Borrowings with an original contractual maturity of greater than one year are classified as long-term debt.
[4] Consists of long-term debt, subordinated deferrable debt and total members' subordinated debt reported on the consolidated balance sheets. Maturity classification is based on the original contractual maturity as of the date of issuance of the debt.

Our outstanding debt volume generally increases and decreases in response to member loan demand. As outstanding loan balances increased during the year ended May 31, 2018, our debt volume also increased. Total debt outstanding of $24,633 million as of May 31, 2018, increased by $1,173 million, or 5%, from May 31, 2017. The increase was primarily attributable to an increase in dealer medium-term notes of $638 million; an increase in Farmer Mac notes payable of $378 million; an aggregate increase in member commercial paper, select notes and daily liquidity fund notes of $230 million; and an increase in dealer commercial paper outstanding of $65 million. These increases were partially offset by a decrease in Guaranteed Underwriter Program notes payable of $129 million.

Below is a summary of significant financing activities during fiscal year 2018.

- On November 9, 2017, we closed a $750 million committed loan facility ("Series M") from the Federal Financing Bank under the Guaranteed Underwriter Program.

- On November 20, 2017, we amended and restated the three-year and five-year committed bank revolving line of credit agreements to extend the maturity dates to November 20, 2020 and November 20, 2022, respectively, and to terminate certain third-party bank commitments.

- On January 16, 2018, we redeemed $325 million of notes payable outstanding, with an effective interest rate of 2.10% and an original maturity of April 15, 2026, under the Guaranteed Underwriter Program.

- On February 26, 2018, we amended the revolving note purchase agreement with Farmer Mac, dated March 24, 2011 to increase the facility amount from $4,800 million to $5,200 million. Under the amended agreement, we currently can borrow, subject to market conditions, up to $5,200 million at any time through January 11, 2022.

Member Investments

Debt securities issued to our members represent an important, stable source of funding. Table 12 displays outstanding member debt, by debt product type, as of May 31, 2018 and 2017.

Table 12: Member Investments

| | May 31, 2018 | | 2017 | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | Amount | % of Total [1] | Amount | % of Total [1] | Increase/(Decrease) |
| Commercial paper | $1,202,105 | 53 % | $928,158 | 48 % | $ 273,947 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Select notes | 780,472 | 100 | 696,889 | 100 | 83,583 | |
| Daily liquidity fund notes | 400,635 | 100 | 527,990 | 100 | (127,355 | ) |
| Medium-term notes | 643,821 | 18 | 612,951 | 20 | 30,870 | |
| Members' subordinated certificates | 1,379,982 | 100 | 1,419,025 | 100 | (39,043 | ) |
| Total outstanding member debt | $4,407,015 | | $4,185,013 | | $ 222,002 | |
| Percentage of total debt outstanding | 18 | % | 18 | % | | |

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(1) Represents outstanding debt attributable to members for each debt product type as a percentage of the total outstanding debt for each debt product type.

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Member investments accounted for 18% of total debt outstanding as of both May 31, 2018 and 2017. Over the last three fiscal years, outstanding member investments have averaged $4,328 million on a quarterly basis.

Short-Term Borrowings

Short-term borrowings consist of borrowings with an original contractual maturity of one year or less and do not include the current portion of long-term debt. Short-term borrowings totaled $3,796 million and accounted for 15% of total debt outstanding as of May 31, 2018, compared with $3,343 million, or 14%, of total debt outstanding as of May 31, 2017. See Table 32: Short-Term Borrowings below under "Liquidity Risk" and "Note 5—Short-Term Borrowings" for detail on the composition of our short-term borrowings.

Long-Term and Subordinated Debt

Long-term debt, defined as debt with an original contractual maturity term of greater than one year, primarily consists of medium-term notes, collateral trust bonds, notes payable under the Guaranteed Underwriter Program and notes payable under our note purchase agreement with Farmer Mac. Subordinated debt consists of subordinated deferrable debt and members' subordinated certificates. Our subordinated deferrable debt and members' subordinated certificates have original contractual maturity terms of greater than one year.

Long-term and subordinated debt totaled $20,837 million and accounted for 85% of total debt outstanding as of May 31, 2018, compared with $20,117 million, or 86%, of total debt outstanding as of May 31, 2017. As discussed above, the increase in total debt outstanding, including long-term and subordinated debt, was primarily due to the issuance of debt to fund the growth in our loan portfolio. See Table 33: Issuances and Repayments of Long-Term and Subordinated Debt below under "Liquidity Risk" for a summary of long-term subordinated debt issuances and repayments for the year ended May 31, 2018.

Collateral Pledged

We are required to pledge loans or other collateral in borrowing transactions under our collateral trust bond indentures, note purchase agreements with Farmer Mac and bond agreements under the Guaranteed Underwriter Program. We are required to maintain pledged collateral equal to at least 100% of the face amount of outstanding borrowings. However, we typically maintain pledged collateral in excess of the required percentage to ensure that required collateral levels are maintained and to facilitate the timely execution of debt issuances by reducing or eliminating the lead time to pledge additional collateral. Under the provisions of our committed bank revolving line of credit agreements, the excess collateral that we are allowed to pledge cannot exceed 150% of the outstanding borrowings under our collateral trust bond indentures, Farmer Mac note purchase agreements or the Guaranteed Underwriter Program. In certain cases, provided that all conditions of eligibility under the different programs are satisfied, we may withdraw excess pledged collateral or transfer collateral from one borrowing program to another to facilitate a new debt issuance.

Table 13 displays the collateral coverage ratios as of May 31, 2018 and 2017 for the debt agreements noted above that require us to pledge collateral.

Table 13: Collateral Pledged

| | Requirement/Limit | | Actual[1] | |
|---|---|---|---|---|
| | Debt | Committed | May 31, | |
| Debt Agreement | Indenture | Bank | 2018 | 2017 |
| | Minimum | Revolving | | |
| | | Line of | | |

| | | Credit Agreements Maximum | | |
|---|---|---|---|---|
| Collateral trust bonds 1994 indenture | 100 % | 150 % | 111% | 117% |
| Collateral trust bonds 2007 indenture | 100 | 150 | 114 | 115 |
| Guaranteed Underwriter Program notes payable | 100 | 150 | 119 | 117 |
| Farmer Mac notes payable | 100 | 150 | 115 | 117 |
| Clean Renewable Energy Bonds Series 2009A | 100 | 150 | 109 | 113 |

(1) Calculated based on the amount of collateral pledged divided by the face amount of outstanding secured debt.

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Of our total debt outstanding of $24,633 million as of May 31, 2018, $15,398 million, or 63%, was secured by pledged loans totaling $18,145 million. In comparison, of our total debt outstanding of $23,460 million as of May 31, 2017, $15,146 million, or 65%, was secured by pledged loans totaling $17,941 million. Total debt outstanding on our consolidated balance sheet is presented net of unamortized discounts and issuance costs. However, our collateral pledging requirements are based on the face amount of secured outstanding debt, which does not take into consideration the impact of net unamortized discounts and issuance costs.

Table 14 displays the unpaid principal balance of loans pledged for secured debt, the excess collateral pledged and unencumbered loans as of May 31, 2018 and 2017.

Table 14: Unencumbered Loans

| | May 31, | |
|---|---|---|
| (Dollars in thousands) | 2018 | 2017 |
| Total loans outstanding[(1)] | $25,167,494 | $24,356,330 |
| Less: Loans required to be pledged for secured debt [(2)] | (15,677,138 ) | (15,435,062 ) |
| Loans pledged in excess of requirement[(2)(3)] | (2,467,444 ) | (2,505,804 ) |
| Total pledged loans | $(18,144,582) | $(17,940,866) |
| Unencumbered loans | $7,022,912 | $6,415,464 |
| Unencumbered loans as a percentage of total loans | 28 % | 26 % |

[(1)]Reflects unpaid principal balance. Excludes unamortized deferred loan origination costs of $11 million as of both May 31, 2018 and 2017.
[(2)]Reflects unpaid principal balance of pledged loans.
[(3)]Excludes cash collateral pledged to secure debt. If there is an event of default under most of our indentures, we can only withdraw the excess collateral
if we substitute cash or permitted investments of equal value.

As displayed above in Table 14, we had excess loans pledged as collateral totaling $2,467 million and $2,506 million as of May 31, 2018 and 2017, respectively. We typically pledge loans in excess of the required amount for the following reasons: (i) our distribution and power supply loans are typically amortizing loans that require scheduled principal payments over the life of the loan, whereas the debt securities issued under secured indentures and agreements typically have bullet maturities; (ii) distribution and power supply borrowers have the option to prepay their loans; and (iii) individual loans may become ineligible for various reasons, some of which may be temporary.

We provide additional information on our borrowings, including the maturity profile, below in “Liquidity Risk.” Refer to “Note 4—Loans—Pledging of Loans” for additional information related to pledged collateral. Also refer to “Note 5—Short-Term Borrowings”, “Note 6—Long-Term Debt”, “Note 7—Subordinated Deferrable Debt” and “Note 8—Members’ Subordinated Certificates” for a more detailed description of each of our debt types.

Equity

Table 15 presents the components of total CFC equity, total equity and total members’ equity as of May 31, 2018 and 2017. As displayed in Table 15, total members’ equity excludes the impact of cumulative unrealized derivative forward value gains (losses) recorded in earnings.

Table 15: Equity

| (Dollars in thousands) | May 31, 2018 | 2017 | Change |
|---|---|---|---|
| Membership fees and education fund: | | | |
| Membership fees | $969 | $971 | $(2) |
| Educational fund | 1,976 | 1,929 | 47 |
| Total membership fees and educational fund | 2,945 | 2,900 | 45 |
| Patronage capital allocated | 811,493 | 761,701 | 49,792 |
| Members' capital reserve | 687,785 | 630,305 | 57,480 |
| Unallocated net loss: | | | |
| Prior year-end cumulative derivative forward value losses | (332,525) | (507,904) | 175,379 |
| Current year derivative forward value gains[1] | 301,694 | 175,379 | 126,315 |
| Current year-end cumulative derivative forward value losses | (30,831) | (332,525) | 301,694 |
| Other unallocated net loss | (5,603) | (5,603) | — |
| Unallocated net loss | (36,434) | (338,128) | 301,694 |
| CFC retained equity | 1,465,789 | 1,056,778 | 409,011 |
| Accumulated other comprehensive income (loss) | 8,544 | 13,175 | (4,631) |
| Total CFC equity | 1,474,333 | 1,069,953 | 404,380 |
| Noncontrolling interests | 31,520 | 28,852 | 2,668 |
| Total equity | $1,505,853 | $1,098,805 | $407,048 |
| | | | |
| Members' equity: | | | |
| Total CFC equity | $1,474,333 | $1,069,953 | $404,380 |
| Excludes: | | | |
| Accumulated other comprehensive income | 8,544 | 13,175 | (4,631) |
| Current year-end cumulative derivative forward value losses | (30,831) | (332,525) | 301,694 |
| Subtotal | (22,287) | (319,350) | 297,063 |
| Total members' equity[2] | $1,496,620 | $1,389,303 | $107,317 |

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[1] Represents derivative forward value gains (losses) for CFC only, as total CFC equity does not include the noncontrolling interests of the variable interest entities NCSC and RTFC, which we are required to consolidate. See "Note 14—Business Segments" for the statements of operations for CFC.
[2] See "Non-GAAP Financial Measures" for details on the calculation of this non-GAAP measure and the reconciliation to the most comparable GAAP measures.

Total equity increased by $407 million during fiscal year 2018 to $1,506 million as of May 31, 2018, attributable to our reported net income of $457 million, which was partially offset by patronage capital retirement of $45 million in September 2017.

In July 2018, the CFC Board of Directors authorized the allocation of fiscal year 2018 adjusted net income as follows: $95 million to members in the form of patronage capital; $57 million to the members' capital reserve and $1 million to the cooperative educational fund. The amount of patronage capital allocated each year by CFC's Board of Directors is based on adjusted non-GAAP net income, which excludes the impact of derivative forward value gains (losses). See "Non-GAAP Financial Measures" for information on adjusted net income.

In July 2018, the CFC Board of Directors also authorized the retirement of patronage capital totaling $48 million, which represented 50% of the patronage capital allocation for fiscal year 2018. We expect to return this amount to members in cash in the first quarter of fiscal year 2019. The remaining portion of the allocated amount will be retained by CFC for 25 years under guidelines adopted by the CFC Board of Directors in June 2009.

In July 2017, the CFC Board of Directors authorized the retirement of allocated net earnings totaling $45 million, which represented 50% of the patronage capital amount of $90 million allocated to members for fiscal year 2017. The $45 million was returned to members in cash in September 2017.

The CFC Board of Directors is required to make annual allocations of adjusted net income, if any. CFC has made annual retirements of allocated net earnings in 38 of the last 39 fiscal years; however, future retirements of allocated amounts are determined based on CFC's financial condition. The CFC Board of Directors has the authority to change the current practice for allocating and retiring net earnings at any time, subject to applicable laws. See "Item 1. Business—Allocation and Retirement of Patronage Capital" for additional information.

OFF-BALANCE SHEET ARRANGEMENTS

In the ordinary course of business, we engage in financial transactions that are not presented on our consolidated balance sheets, or may be recorded on our consolidated balance sheets in amounts that are different from the full contract or notional amount of the transaction. Our off-balance sheet arrangements consist primarily of guarantees of member obligations and unadvanced loan commitments intended to meet the financial needs of our members.

Guarantees

We provide guarantees for certain contractual obligations of our members to assist them in obtaining various forms of financing. We use the same credit policies and monitoring procedures in providing guarantees as we do for loans and commitments. If a member defaults on its obligation, we are obligated to pay required amounts pursuant to our guarantees. Meeting our guarantee obligations satisfies the underlying obligation of our member systems and prevents the exercise of remedies by the guarantee beneficiary based upon a payment default by a member. In general, the member is required to repay any amount advanced by us with accrued interest, pursuant to the documents evidencing the member's reimbursement obligation. Table 16 displays the notional amount of our outstanding guarantee obligations, by guarantee type and by company, as of May 31, 2018 and 2017.

Table 16: Guarantees Outstanding

| | May 31, | | Increase/ |
|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | (Decrease) |
| Guarantee type: | | | |
| Long-term tax-exempt bonds | $316,985 | $468,145 | $(151,160) |
| Letters of credit | 343,970 | 307,321 | 36,649 |
| Other guarantees | 144,206 | 114,151 | 30,055 |
| Total | $805,161 | $889,617 | $(84,456) |
| | | | |
| Company: | | | |
| CFC | $793,156 | $874,920 | $(81,764) |
| NCSC | 10,431 | 13,123 | (2,692) |
| RTFC | 1,574 | 1,574 | — |
| Total | $805,161 | $889,617 | $(84,456) |

Of the total notional amount of our outstanding guarantee obligations of $805 million and $890 million as of May 31, 2018 and 2017, respectively, 57% and 67%, respectively, were secured by a mortgage lien on substantially all of the assets and future revenue of the borrowers.

In addition to providing a guarantee on long-term tax-exempt bonds issued by member cooperatives totaling $317 million as of May 31, 2018, we also were the liquidity provider on $250 million of those tax-exempt bonds. As liquidity provider, we may be required to purchase bonds that are tendered or put by investors. Investors provide notice to the remarketing agent that they will tender or put a certain amount of bonds at the next interest rate reset date. If the remarketing agent is unable to

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sell such bonds to other investors by the next interest rate reset date, we have unconditionally agreed to purchase such bonds. We were not required to perform as liquidity provider pursuant to these obligations during fiscal year 2018 or 2017.

We had outstanding letters of credit for the benefit of our members totaling $344 million as of May 31, 2018. These letters of credit relate to obligations for which we may be required to advance funds based on various trigger events specified in the letter of credit agreements. If we are required to advance funds, the member is obligated to repay the advance amount and accrued interest to us. In addition to these letters of credit, we had master letter of credit facilities in place under which we may be required to issue letters of credit to third parties for the benefit of our members up to an additional $67 million as of May 31, 2018. All of our master letter of credit facilities as of May 31, 2018 were subject to material adverse change clauses at the time of issuance. Prior to issuing a letter of credit under these facilities, we confirm that there has been no material adverse change in the business or condition, financial or otherwise, of the borrower since the time the loan was approved and that the borrower is currently in compliance with the letter of credit terms and conditions.

Table 17 presents the maturities for each of the next five fiscal years and thereafter of the notional amount of our outstanding guarantee obligations of $805 million as of May 31, 2018.

Table 17: Maturities of Guarantee Obligations

| | Outstanding | Maturities of Guarantee Obligations | | | | | |
|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | Amount | 2019 | 2020 | 2021 | 2022 | 2023 | Thereafter |
| Guarantees | $ 805,161 | $265,684 | $66,142 | $121,700 | $27,515 | $160,541 | $163,579 |

We recorded a guarantee liability of $11 million and $15 million as of May 31, 2018 and 2017, respectively, for our guarantee and liquidity obligations associated with our members’ debt. We provide additional information about our guarantee obligations in “Note 12—Guarantees.”

Unadvanced Loan Commitments

Unadvanced loan commitments represent approved and executed loan contracts for which funds have not been advanced to borrowers. Our line of credit commitments include both contracts that are subject to material adverse change clauses and contracts that are not subject to material adverse change clauses, while our long-term loan commitments are typically subject to material adverse change clauses.

Table 18 displays the amount of unadvanced loan commitments, which consist of line of credit and long-term loan commitments, as of May 31, 2018 and 2017.

Table 18: Unadvanced Loan Commitments

| | May 31, 2018 | | 2017 | | Increase/ |
|---|---|---|---|---|---|
| (Dollars in thousands) | Amount | % of Total | Amount | % of Total | (Decrease) |
| Line of credit commitments: | | | | | |
| Conditional[1] | $4,835,434 | 38 % | $5,170,393 | 41 % | $(334,959) |
| Unconditional[2] | 2,857,350 | 23 | 2,602,262 | 21 | 255,088 |
| Total line of credit unadvanced commitments | 7,692,784 | 61 | 7,772,655 | 62 | (79,871 ) |
| Total long-term loan unadvanced commitments[1] | 4,952,834 | 39 | 4,802,319 | 38 | 150,515 |
| Total unadvanced loan commitments | $12,645,618 | 100% | $12,574,974 | 100% | $70,644 |

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(1)Represents amount related to facilities that are subject to material adverse change clauses.
(2)Represents amount related to facilities that are not subject to material adverse change clauses.

Table 19 presents the amount of unadvanced loan commitments, by loan type, as of May 31, 2018 and the maturities of the commitment amounts for each of the next five fiscal years and thereafter.

Table 19: Notional Maturities of Unadvanced Loan Commitments

| | Available | Notional Maturities of Unadvanced Loan Commitments | | | | | |
|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | Balance | 2019 | 2020 | 2021 | 2022 | 2023 | Thereafter |
| Line of credit | $7,692,784 | $4,168,751 | $710,763 | $805,508 | $770,971 | $1,211,791 | $ 25,000 |
| Long-term loans | 4,952,834 | 883,840 | 586,005 | 652,499 | 1,714,338 | 1,104,185 | 11,967 |
| Total | $12,645,618 | $5,052,591 | $1,296,768 | $1,458,007 | $2,485,309 | $2,315,976 | $ 36,967 |

Unadvanced line of credit commitments accounted for 61% of total unadvanced loan commitments as of May 31, 2018, while unadvanced long-term loan commitments accounted for 39% of total unadvanced loan commitments. Unadvanced line of credit commitments are typically revolving facilities for periods not to exceed five years. Unadvanced line of credit commitments generally serve as supplemental back-up liquidity to our borrowers. Historically, borrowers have not drawn the full commitment amount for line of credit facilities, and we have experienced a very low utilization rate on line of credit loan facilities regardless of whether or not we are obligated to fund the facility where a material adverse change exists.

Our unadvanced long-term loan commitments have a five-year draw period under which a borrower may advance funds prior to the expiration of the commitment. We expect that the majority of the long-term unadvanced loan commitments of $4,953 million will be advanced prior to the expiration of the commitment.

Because we historically have experienced a very low utilization rate on line of credit loan facilities, which account for the majority of our total unadvanced loan commitments, we believe the unadvanced loan commitment total of $12,646 million as of May 31, 2018 is not necessarily representative of our future funding requirements.

Unadvanced Loan Commitments—Conditional

The substantial majority of our line of credit commitments and all of our unadvanced long-term loan commitments include material adverse change clauses. Unadvanced loan commitments subject to material adverse change clauses totaled $9,789 million and $9,973 million as of May 31, 2018 and 2017, respectively, and accounted for 77% and 79% of the combined total of unadvanced line of credit and long-term loan commitments as of May 31, 2018 and 2017, respectively. Prior to making advances on these facilities, we confirm that there has been no material adverse change in the borrower's business or condition, financial or otherwise, since the time the loan was approved and confirm that the borrower is currently in compliance with loan terms and conditions. In some cases, the borrower's access to the full amount of the facility is further constrained by use of proceeds restrictions, imposition of borrower-specific restrictions, or by additional conditions that must be met prior to advancing funds. Since we generally do not charge a fee for the borrower to have an unadvanced amount on a loan facility that is subject to a material adverse change clause, our borrowers tend to request amounts in excess of their immediate estimated loan requirements.

Unadvanced Loan Commitments—Unconditional

Unadvanced loan commitments not subject to material adverse change clauses at the time of each advance consisted of unadvanced committed lines of credit totaling $2,857 million and $2,602 million as of May 31, 2018 and 2017, respectively. For contracts not subject to a material adverse change clause, we are generally required to advance amounts on the committed facilities as long as the borrower is in compliance with the terms and conditions of the facility.

Syndicated loan facilities, where the pricing is set at a spread over a market index rate as agreed upon by all of the participating financial institutions based on market conditions at the time of syndication, accounted for 86% of unconditional line of credit commitments as of May 31, 2018. The remaining 14% represented unconditional committed line of credit loans, which under any new advance would be made at rates determined by us.

Table 20 presents the maturities for each of the next five fiscal years of the notional amount of unconditional committed lines of credit not subject to a material adverse change clause as of May 31, 2018.

Table 20: Maturities of Notional Amount of Unconditional Committed Lines of Credit

| (Dollars in thousands) | Available Balance | Notional Maturities of Unconditional Committed Lines of Credit | | | | |
|---|---|---|---|---|---|---|
| | | 2019 | 2020 | 2021 | 2022 | 2023 |
| Committed lines of credit | $2,857,350 | $279,285 | $435,151 | $444,326 | $644,178 | $1,054,410 |

RISK MANAGEMENT

Overview

We face a variety of risks that can significantly affect our financial performance, liquidity, reputation and ability to meet the expectations of our members, investors and other stakeholders. As a financial services company, the major categories of risk exposures inherent in our business activities include credit risk, liquidity risk, market risk and operational risk. These risk categories are summarized below.

- Credit risk is the risk that a borrower or other counterparty will be unable to meet its obligations in accordance with agreed-upon terms.

- Liquidity risk is the risk that we will be unable to fund our operations and meet our contractual obligations or that we will be unable to fund new loans to borrowers at a reasonable cost and tenor in a timely manner.

- Market risk is the risk that changes in market variables, such as movements in interest rates, may adversely affect the match between the timing of the contractual maturities, re-pricing and prepayments of our financial assets and the related financial liabilities funding those assets.

- Operational risk is the risk of loss resulting from inadequate or failed internal controls, processes, systems, human error or external events. Operational risk also includes compliance risk, fiduciary risk, reputational risk and litigation risk.

Effective risk management is critical to our overall operations and in achieving our primary objective of providing cost-based financial products to our rural electric members while maintaining the sound financial results required for investment-grade credit ratings on our rated debt instruments. Accordingly, we have a risk-management framework that is intended to govern the principal risks we face in conducting our business and the aggregate amount of risk we are willing to accept, referred to as risk appetite, in the context of CFC’s mission and strategic objectives and initiatives.

Risk-Management Framework

Our risk-management framework consists of defined policies, procedures and risk tolerances that are intended to align with CFC’s mission. The CFC Board of Directors is responsible for risk governance by approving the enterprise risk-management framework and providing oversight on risk policies, risk appetite and our performance against established goals. In fulfilling its risk governance responsibility, the CFC Board of Directors receives periodic reports on business activities from management. The CFC Board of Directors reviews CFC’s risk profile and management’s assessment of those risks throughout the year at its periodic meetings. The board also establishes CFC’s loan policies and has established a Loan Committee of the board comprising no fewer than 10 directors that reviews the performance of the loan portfolio in accordance with those policies. For additional information about the role of the CFC Board of Directors in risk governance and oversight, see “Item 10. Directors, Executive Officers and Corporate Governance.”

Management is responsible for execution of the risk-management framework, risk policy formation and daily management of the risks associated with our business. Management executes its responsibility by establishing processes for identifying, measuring, assessing, managing, monitoring and reporting risks. Management and operating groups maintain policies and procedures, specific to each major risk category, to identify and measure our primary risk exposures at the transaction, obligor and portfolio levels and ensure that our exposures remain within prescribed limits. Management also is responsible for establishing and maintaining internal controls to mitigate key risks. We have a number of management-level risk oversight committees across the organization and groups within the organization that have a defined set of authorities and responsibilities specific to one or more risk types, including the Corporate Credit Committee, Credit Risk Management group, Asset Liability Committee, Investment Management Committee, Corporate Compliance group, Internal Audit group and Disclosure Committee. These risk oversight committees and groups collectively help management facilitate enterprise-wide understanding and monitoring of CFC's risk profile and the control processes with respect to our inherent risks. Management and the risk oversight committees periodically report actual results, significant current and emerging risks, initiatives and risk-management concerns to the CFC Board of Directors.

CREDIT RISK

Our loan portfolio, which represents the largest component of assets on our balance sheet, and guarantees account for the substantial majority of our credit risk exposure. We also engage in certain non-lending activities that may give rise to credit and counterparty settlement risk, including the purchase of investment securities and entering into derivative transactions to manage interest rate risk. Our primary credit exposure is to rural electric cooperatives that provide essential electric services to end-users, the majority of which are residential customers. We also have a limited portfolio of loans to not-for-profit and for-profit telecommunication companies.

Credit Risk Management

We manage portfolio and borrower credit risk consistent with credit policies established by the CFC Board of Directors and through credit underwriting, approval and monitoring processes and practices adopted by management. Our board-established credit policies include guidelines regarding the types of credit products we offer, limits on credit we extend to individual borrowers, approval authorities delegated to management, and use of syndications and loan sales. We maintain an internal risk rating system in which we assign a rating to each borrower and credit facility. We review and update the risk ratings at least annually. Assigned risk ratings inform our credit approval, borrower monitoring and portfolio review processes. Our Corporate Credit Committee approves individual credit actions within its own authority and together with our Credit Risk Management group, establishes standards for credit underwriting, oversees credits deemed to be higher risk, reviews assigned risk ratings for accuracy, and monitors the overall credit quality and performance statistics of our loan portfolio and guarantees.

Loan and Guarantee Portfolio Credit Risk

Below we provide information on the credit risk profile of our loan portfolio and guarantees, including security provisions, loan concentration, credit performance and our allowance for loan losses.

Security Provisions

Except when providing line of credit loans, we generally lend to our members on a senior secured basis. Long-term loans are generally secured on parity with other secured lenders (primarily RUS), if any, by all assets and revenue of the borrower with exceptions typical in utility mortgages. Line of credit loans are generally unsecured. In addition to the collateral pledged to secure our loans, distribution and power supply borrowers also are required to set rates charged to customers to achieve certain specified financial ratios.

Table 21 presents, by loan type and by company, the amount and percentage of secured and unsecured loans in our loan portfolio as of May 31, 2018 and 2017. Of our total loans outstanding, 93% were secured and 7% were unsecured as of May 31, 2018. Of our total loans outstanding, 92% were secured and 8% were unsecured as of May 31, 2017.

Table 21 : Loan Portfolio Security Profile[1]

| | May 31, 2018 | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | Secured | % of Total | Unsecured | % of Total | Total |
| Loan type: | | | | | |
| Long-term loans: | | | | | |
| Long-term fixed-rate loans | $22,220,087 | 98 % | $476,098 | 2 % | $22,696,185 |
| Long-term variable-rate loans | 996,970 | 96 | 42,521 | 4 | 1,039,491 |
| Total long-term loans | 23,217,057 | 98 | 518,619 | 2 | 23,735,676 |
| Line of credit loans | 69,097 | 5 | 1,362,721 | 95 | 1,431,818 |
| Total loans outstanding | $23,286,154 | 93 | $1,881,340 | 7 | $25,167,494 |
| | | | | | |
| Company: | | | | | |
| CFC | $22,233,592 | 93 % | $1,784,327 | 7 % | $24,017,919 |
| NCSC | 703,396 | 89 | 83,061 | 11 | 786,457 |
| RTFC | 349,166 | 96 | 13,952 | 4 | 363,118 |
| Total loans outstanding | $23,286,154 | 93 | $1,881,340 | 7 | $25,167,494 |

| | May 31, 2017 | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | Secured | % of Total | Unsecured | % of Total | Total |
| Loan type: | | | | | |
| Long-term loans: | | | | | |
| Long-term fixed-rate loans | $21,503,871 | 97 % | $632,819 | 3 % | $22,136,690 |
| Long-term variable-rate loans | 795,326 | 94 | 52,093 | 6 | 847,419 |
| Total long-term loans | 22,299,197 | 97 | 684,912 | 3 | 22,984,109 |
| Line of credit loans | 54,258 | 4 | 1,317,963 | 96 | 1,372,221 |
| Total loans outstanding | $22,353,455 | 92 | $2,002,875 | 8 | $24,356,330 |
| | | | | | |
| Company: | | | | | |
| CFC | $21,591,723 | 92 % | $1,796,264 | 8 % | $23,387,987 |
| NCSC | 424,636 | 69 | 189,288 | 31 | 613,924 |
| RTFC | 337,096 | 95 | 17,323 | 5 | 354,419 |
| Total loans outstanding | $22,353,455 | 92 | $2,002,875 | 8 | $24,356,330 |

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[1]Excludes deferred loan origination costs of $11 million as of both May 31, 2018 and 2017.

As part of our strategy in managing our credit risk exposure, we entered into a long-term standby purchase commitment agreement with Farmer Mac in fiscal year 2016. Under this agreement, we may designate certain loans to be covered under the commitment, as approved by Farmer Mac, and in the event any such loan later goes into payment default for at least 90 days, upon request by us, Farmer Mac must purchase such loan at par value. The outstanding principal balance of loans covered under this agreement totaled $660 million as of May 31, 2018, compared with $843 million as of May 31, 2017. No loans have been put to Farmer Mac for purchase pursuant to this agreement. Our credit exposure is also mitigated by long-term loans guaranteed by RUS. Guaranteed RUS loans totaled $161 million and $167 million as of May 31, 2018 and 2017, respectively.

Credit Concentration

Concentrations may exist when there are amounts loaned to borrowers engaged in similar activities or in geographic areas that would cause them to be similarly impacted by economic or other conditions or when there are large exposures to single borrowers. As a tax-exempt, member-owned finance cooperative, CFC's principal focus is to provide funding to its rural electric utility cooperative members to assist them in acquiring, constructing and operating electric distribution, power supply systems and related facilities. As a result of lending primarily to our rural electric utility cooperative members, we have a loan portfolio subject to single-industry and single-obligor concentrations. Outstanding loans to electric utility organizations represented approximately 99% of the total outstanding loan portfolio as of May 31, 2018, unchanged from May 31, 2017. Although our organizational structure and mission results in single-industry concentration, we serve a geographically diverse group of electric and telecommunications borrowers throughout the United States and its territories, including all 50 states, the District of Columbia, American Samoa and Guam. Our consolidated membership totaled 1,449 members and 216 associates as of May 31, 2018. Despite our credit concentrations, we historically have experienced limited defaults and very low credit losses in our electric loan portfolio. In fiscal year 2018, for the fifth consecutive fiscal year, we had no payment defaults, charge-offs, delinquent loans or nonperforming loans in our electric utility loan portfolio.

Geographic Concentration

We currently have loans outstanding to borrowers in 48 states and the District of Columbia. Texas had the largest concentration of outstanding loans to borrowers in any one state, with approximately 15% of total loans outstanding as of both May 31, 2018 and 2017, respectively, and also the largest concentration of borrowers, with 70 borrowers as of May 31, 2018 and 73 borrowers as of May 31, 2017. In addition to having the largest number of borrowers, Texas also had the largest concentration of electric power supply borrowers. Electric power supply borrowers generally require significantly more capital than electric distribution and telecommunications borrowers. Of our 67 electric power supply borrowers, eight were located in Texas as of May 31, 2018.

Table 22 presents the number of CFC, NCSC and RTFC borrowers and the percentage of total loans outstanding by state or U.S. territory as of May 31, 2018 and 2017.

Table 22: Loan Geographic Concentration

| | May 31, 2018 | | 2017 | |
|---|---|---|---|---|
| U.S. State/Territory | Number of Borrowers | % of Total Loans Outstanding | Number of Borrowers | % of Total Loans Outstanding |
| Texas | 70 | 15.11 % | 73 | 14.86 % |
| Georgia | 48 | 5.83 | 44 | 5.77 |
| Missouri | 48 | 5.43 | 48 | 5.27 |
| Colorado | 26 | 5.41 | 26 | 5.27 |
| Kansas | 30 | 4.77 | 31 | 4.57 |
| Alaska | 17 | 3.79 | 16 | 3.61 |
| Florida | 17 | 3.70 | 17 | 3.17 |
| Illinois | 29 | 3.65 | 27 | 3.43 |
| North Dakota | 18 | 3.42 | 18 | 3.62 |
| South Carolina | 23 | 3.05 | 23 | 3.12 |
| North Carolina | 28 | 3.01 | 28 | 3.17 |
| Indiana | 37 | 2.89 | 38 | 3.04 |
| Kentucky | 25 | 2.86 | 24 | 3.02 |
| Oklahoma | 26 | 2.86 | 26 | 2.95 |
| Minnesota | 53 | 2.84 | 54 | 2.98 |
| Alabama | 27 | 2.28 | 27 | 2.26 |
| Arkansas | 20 | 2.26 | 21 | 2.36 |
| Ohio | 28 | 2.10 | 28 | 2.14 |
| Pennsylvania | 17 | 2.04 | 17 | 2.02 |
| Iowa | 39 | 2.00 | 39 | 1.90 |
| Wisconsin | 24 | 1.91 | 24 | 1.68 |
| Maryland | 2 | 1.67 | 2 | 2.06 |
| Mississippi | 19 | 1.58 | 18 | 1.56 |
| Oregon | 22 | 1.42 | 22 | 1.43 |
| Utah | 6 | 1.39 | 6 | 1.61 |
| Washington | 11 | 1.34 | 11 | 1.32 |
| Virginia | 19 | 1.25 | 18 | 1.42 |
| Louisiana | 10 | 1.25 | 10 | 1.21 |
| Nevada | 6 | 1.00 | 5 | 1.35 |
| Wyoming | 13 | 0.99 | 15 | 1.09 |
| Michigan | 13 | 0.92 | 14 | 0.62 |
| South Dakota | 31 | 0.86 | 32 | 0.93 |
| Montana | 25 | 0.78 | 25 | 0.71 |
| Arizona | 11 | 0.73 | 11 | 0.81 |
| Hawaii | 2 | 0.52 | 2 | 0.60 |
| Idaho | 12 | 0.51 | 12 | 0.56 |
| Tennessee | 18 | 0.51 | 17 | 0.36 |
| Delaware | 3 | 0.44 | 3 | 0.48 |
| New Hampshire | 1 | 0.36 | 1 | 0.37 |
| New Mexico | 16 | 0.27 | 16 | 0.29 |
| Massachusetts | 1 | 0.24 | 1 | 0.25 |
| Vermont | 5 | 0.21 | 4 | 0.19 |
| California | 4 | 0.13 | 4 | 0.14 |
| Nebraska | 13 | 0.12 | 16 | 0.13 |

| | | | | | | |
|---|---|---|---|---|---|---|
| New York | 7 | 0.12 | | 6 | 0.12 | |
| New Jersey | 2 | 0.07 | | 2 | 0.07 | |
| West Virginia | 2 | 0.06 | | 2 | 0.06 | |
| Maine | 3 | 0.04 | | 3 | 0.04 | |
| District of Columbia | 1 | 0.01 | | 1 | 0.01 | |
| Total | 928 | 100.00 | % | 928 | 100.00 | % |

Single-Obligor Concentration

Table 23 displays the combined exposure of loans and guarantees outstanding of the 20 largest borrowers, by exposure type and by company, as of May 31, 2018 and 2017. The 20 borrowers with the largest exposure consisted of nine distribution systems, 10 power supply systems and one NCSC associate member as of May 31, 2018. The 20 borrowers with the largest exposure consisted of 10 distribution systems, nine power supply systems and one NCSC associate member as of May 31, 2017. The largest exposure to a single borrower or controlled group represented approximately 2% of total loans and guarantees outstanding as of both May 31, 2018 and 2017.

Table 23: Credit Exposure to 20 Largest Borrowers

| | May 31, 2018 | | 2017 | | Change |
|---|---|---|---|---|---|
| (Dollars in thousands) | Amount | % of Total | Amount | % of Total | |
| By exposure type: | | | | | |
| Loans | $5,613,991 | 22 % | $5,749,885 | 23 % | $(135,894) |
| Guarantees | 347,138 | 1 | 354,619 | 1 | (7,481 ) |
| Total exposure to 20 largest borrowers | 5,961,129 | 23 | 6,104,504 | 24 | (143,375 ) |
| Less: Loans covered under Farmer Mac standby purchase commitment | (354,694 ) | (1 ) | (351,699 ) | (1 ) | (2,995 ) |
| Net exposure to 20 largest borrowers | $5,606,435 | 22 % | $5,752,805 | 23 % | $(146,370) |
| By company: | | | | | |
| CFC | $5,703,723 | 22 % | $5,899,709 | 23 % | $(195,986) |
| NCSC | 257,406 | 1 | 204,795 | 1 | 52,611 |
| Total exposure to 20 largest borrowers | 5,961,129 | 23 | 6,104,504 | 24 | (143,375 ) |
| Less: Loans covered under Farmer Mac standby purchase commitment | (354,694 ) | (1 ) | (351,699 ) | (1 ) | (2,995 ) |
| Net exposure to 20 largest borrowers | $5,606,435 | 22 % | $5,752,805 | 23 % | $(146,370) |

Credit Performance

Assessing and measuring our credit risk is an ongoing process that involves tracking risk ratings, nonperforming loans, economic trends and other indications of credit risk. We monitor and subject each borrower and loan facility in our loan portfolio to an individual risk assessment based on quantitative and qualitative factors. Internal risk ratings and payment status trends are indicators, among others, of the probability of borrower default and level of credit risk in our loan portfolio.

The overall credit risk of our loan portfolio remained low, as evidenced by our strong asset quality metrics, including senior secured positions on most of our loans and low levels of criticized exposure. As displayed in Table 21 above, 93% and 92% of our total outstanding loans were secured as of May 31, 2018 and 2017, respectively. We had no delinquent or nonperforming loans as of May 31, 2018. In addition, in fiscal year 2018, we had no loan defaults or charge-offs. As a result, we now have a sustained period of five consecutive fiscal years for which we have had no credit losses in our electric utility loan portfolio. Below we provide information on certain additional credit quality indicators, including modified loans that are considered to be troubled debt restructurings (“TDRs”), nonperforming loans, net charge-offs and borrower risk ratings.

Troubled Debt Restructurings

We actively monitor problem loans and, from time to time, attempt to work with borrowers to manage such exposures through loan workouts or modifications that better align with the borrower's current ability to pay. A loan restructuring or modification of terms is accounted for as a TDR if, for economic or legal reasons related to the borrower's financial difficulties, a concession is granted to the borrower that we would not otherwise consider. TDR loans generally are initially placed on nonaccrual status, although in many cases such loans were already on nonaccrual status prior to modification. Interest accrued but not collected at the date a loan is placed on nonaccrual status is reversed against earnings. These loans may be returned to performing status and the accrual of interest resumed if the borrower performs under the modified terms for an extended period of time, and we expect the borrower to continue to perform in accordance with the modified terms. In certain limited circumstances in which a TDR loan is current at the modification date, the loan may remain on accrual status at the time of modification.

Table 24 presents the carrying value of loans modified as TDRs and the performance status of these loans as of the end of each of the last five fiscal years. Our last modification of a loan that met the definition of a TDR occurred in fiscal year 2017. Although TDR loans may be returned to performing status if the borrower performs under the modified terms of the loan for an extended period of time, TDR loans are considered individually impaired.

Table 24: Troubled Debt Restructured Loans

| | May 31, 2018 | | 2017 | | 2016 | | 2015 | | 2014 | |
|---|---|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | Carrying Amount | % of Total Loans | Carrying Amount | % of Total Loans | Carrying Amount | % of Total Loans | Carrying Amount | % of Total Loans | Carrying Amount | % of Total Loans |
| TDR loans: | | | | | | | | | | |
| CFC | $6,507 | 0.03% | $6,581 | 0.02% | $6,716 | 0.03% | $7,221 | 0.03% | $7,584 | 0.04% |
| NCSC | — | — | — | — | — | — | 294 | — | — | — |
| RTFC | 6,092 | 0.02 | 6,592 | 0.03 | 10,598 | 0.04 | 4,221 | 0.02 | — | — |
| Total TDR loans | $12,599 | 0.05% | $13,173 | 0.05% | $17,314 | 0.07% | $11,736 | 0.05% | $7,584 | 0.04% |
| | | | | | | | | | | |
| Performance status of TDR loans: | | | | | | | | | | |
| Performing TDR loans | $12,599 | 0.05% | $13,173 | 0.05% | $13,808 | 0.06% | $11,736 | 0.05% | $7,584 | 0.04% |
| Nonperforming TDR loans | — | — | — | — | 3,506 | 0.01 | — | — | — | — |
| Total TDR loans | $12,599 | 0.05% | $13,173 | 0.05% | $17,314 | 0.07% | $11,736 | 0.05% | $7,584 | 0.04% |

As indicated in Table 24 above, we did not have any TDR loans classified as nonperforming as of May 31, 2018 or 2017.

Nonperforming Loans

In addition to TDR loans that may be classified as nonperforming, we also may have nonperforming loans that have not been modified as a TDR loan. We classify such loans as nonperforming at the earlier of the date when we determine: (i) interest or principal payments on the loan is past due 90 days or more; (ii) as a result of court proceedings, the collection of interest or principal payments based on the original contractual terms is not expected; or (iii) the full and timely collection of interest or principal is otherwise uncertain. Once a loan is classified as nonperforming, we generally place the loan on nonaccrual status. Interest accrued but not collected at the date a loan is placed on nonaccrual status is reversed against earnings. Table 25 below presents nonperforming loans as of the end of each of the last five fiscal years.

Table 25: Nonperforming Loans

| | May 31, 2018 | | 2017 | | 2016 | | 2015 | | 2014 | |
|---|---|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | Amount | % of Total Loans | Amount | % of Total Loans | Amount | % of Total Loans | Amount | % of Total Loans | Amount | % of Total Loans |
| Nonperforming loans: | | | | | | | | | | |
| CFC | $— | —% | $ — | —% | $ — | —% | $ — | —% | $— | — % |
| NCSC | — | — | — | — | — | — | — | — | 400 | — |
| RTFC | — | — | — | — | — | — | — | — | 1,695 | 0.01 |
| Total | $— | —% | $ — | —% | $ — | —% | $ — | —% | $2,095 | 0.01% |

We provide additional information on the credit quality of our loan portfolio in "Note 4—Loans."

Net Charge-Offs

Charge-offs represent the amount of a loan that has been removed from our consolidated balance sheet when the loan is deemed uncollectible. Generally the amount of a charge-off is the recorded investment in excess of the fair value of the expected cash flows from the loan, or, if the loan is collateral dependent, the fair value of the underlying collateral securing the loan. We report charge-offs net of amounts recovered on previously charged off loans. Table 26 presents charge-offs, net of recoveries, and the net charge-off rate for each of the last five fiscal years.

Table 26: Net Charge-Offs (Recoveries)

| | Year Ended May 31, | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2016 | 2015 | 2014 |
| Charge-offs: | | | | | |
| RTFC | $— | $2,119 | $— | $999 | $1,606 |
| Recoveries: | | | | | |
| CFC | — | (159) | (214) | (214) | (212) |
| RTFC | — | (100) | — | — | — |
| Total recoveries | — | (259) | (214) | (214) | (212) |
| Net charge-offs (recoveries) | $— | $1,860 | $(214) | $785 | $1,394 |
| Average total loans outstanding | $24,911,559 | $23,834,432 | $22,490,847 | $20,821,944 | $20,412,340 |
| Net charge-off rate(1) | 0.00 % | 0.01 % | 0.00 % | 0.00 % | 0.01 % |

(1)Calculated based on annualized net charge-offs (recoveries) for the period divided by average total outstanding loans for the period.

We had no loan defaults or charge-offs during fiscal year 2018. The gross charge-offs of $5 million over the last five fiscal years were all attributable to our RTFC telecommunications loan portfolio. We now have experienced an extended period of five consecutive fiscal years for which we have had no charge-offs in our electric utility loan portfolio.

Borrower Risk Ratings

Our borrower risk ratings are aligned with banking regulatory agency credit risk rating definitions of pass and criticized classifications, with loans classified as criticized further classified as special mention, substandard or doubtful. Pass ratings reflect relatively low probability of default, while criticized ratings have a higher probability of default. Loans with borrowers classified as criticized totaled $178 million, or 0.7%, of total loans outstanding as of May 31, 2018. Of this amount, $171 million was classified as substandard. In comparison, loans with borrowers classified as criticized totaled $120 million, or 0.5%, of total loans outstanding as of May 31, 2017. Of this amount, $8 million was classified as substandard. We did not have any loans classified as doubtful as of May 31, 2018 or 2017. See “Note 4—Loans” for a description of each of the risk rating classifications.

Historical Loss History

In its 49-year history, CFC has experienced only 16 defaults and cumulative net charge-offs totaling $86 million for the electric utility loan portfolio. Of this amount, $67 million was attributable to electric utility power supply cooperatives and $19 million was attributable to electric distribution cooperatives. Loans to electric utility cooperatives, our principal lending market, typically have a relatively low risk of default because of the business model of electric utility cooperatives. They provide essential services to end-users, the majority of which are residential customers. They tend to operate in exclusive territories, the majority of which are in states not subject to rate regulation. As such, they have the ability to pass through cost increases to their customers without first obtaining state regulatory approval. In addition, they tend to adhere to a conservative business strategy model that has historically resulted in a relatively stable, resilient operating environment and overall strong financial performance and credit strength for the electric cooperative network.

In comparison, we have had 15 defaults and cumulative net charge-offs attributable to telecommunication borrowers totaling $427 million, the most significant of which was a charge-off of $354 million in fiscal year 2011. This charge-off related to outstanding loans to Innovative Communications Corporation (“ICC”), a former RTFC member, and the transfer of ICC’s assets in foreclosure to CAH.

As discussed above under “Credit Concentration,” outstanding loans to electric utility cooperatives totaled $24,804 million, or 99%, of the total outstanding loan portfolio, as of May 31, 2018, while outstanding RTFC telecommunications loans totaled $363 million, or 1%, of the total outstanding loan portfolio, as of May 31, 2018.

Allowance for Loan Losses

The allowance for loan losses represents management’s estimate of probable losses inherent in our loan portfolio as of each balance sheet date. We determine the allowance based on borrower risk ratings, historical loss experience, specific problem loans, economic conditions and other pertinent factors that, in management’s judgment, may affect the risk of loss in our loan portfolio.

Table 27 summarizes changes in the allowance for loan losses for the past five fiscal years and a comparison of the allowance by company as of the end of each of those years.

Table 27: Allowance for Loan Losses

| | Year Ended May 31, | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2016 | 2015 | 2014 |
| Beginning balance | $37,376 | $33,258 | $33,690 | $56,429 | $54,325 |
| Provision (benefit) for loan losses | (18,575 ) | 5,978 | (646 ) | (21,954 ) | 3,498 |
| Net (charge-offs) recoveries | — | (1,860 ) | 214 | (785 ) | (1,394 ) |
| Ending balance | $18,801 | $37,376 | $33,258 | $33,690 | $56,429 |
| Allowance for loan losses by company: | | | | | |
| CFC | $12,300 | $29,499 | $24,559 | $23,716 | $45,600 |
| NCSC | 2,082 | 2,910 | 3,134 | 5,441 | 6,547 |
| RTFC | 4,419 | 4,967 | 5,565 | 4,533 | 4,282 |
| Total | $18,801 | $37,376 | $33,258 | $33,690 | $56,429 |
| Allowance coverage ratios: | | | | | |
| Total loans outstanding[1] | $25,167,494 | $24,356,330 | $23,152,517 | $21,459,220 | $20,466,925 |
| Percentage of total loans outstanding | 0.07 % | 0.15 % | 0.14 % | 0.16 % | 0.28 % |
| Percentage of total nonperforming loans outstanding | — | — | — | — | 2,693.51 |
| Percentage of total performing TDR loans outstanding | 149.23 | 283.73 | 240.86 | 287.07 | 744.05 |
| Percentage of total nonperforming TDR loans outstanding | — | — | 948.60 | — | — |
| Percentage of loans on nonaccrual status | — | — | 948.60 | 287.07 | 583.00 |

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(1) Excludes unamortized deferred loan origination costs of $11 million as of both May 31, 2018 and 2017, and $10 million as of May 31, 2016, 2015 and 2014.

Our allowance for loan losses decreased by $18 million to $19 million as of May 31, 2018, from $37 million as of May 31, 2017, while the allowance coverage ratio decreased to 0.07% as of May 31, 2018, from 0.15% as of May 31, 2017. In the fourth quarter of fiscal year 2018, we increased the recovery rate assumptions used in determining the collective allowance for our electric distribution and power supply loan portfolios to reflect management's current assessment of expected losses in the event of default on a loan in these portfolios. The increase in recovery rate assumptions for these portfolios was the primary driver of the $18 million reduction in the allowance for loan losses. As discussed above, our electric utility loan portfolio has continued to exhibit strong credit performance. In fiscal year 2018, for the fifth consecutive fiscal year, we had no payment defaults, charge-offs, delinquent loans or nonperforming loans in our electric utility loan portfolio. In addition, 93% of the loans in our total loan portfolio were secured as of May 31, 2018, up from 92% as of May 31, 2017.

As mentioned above under "Borrower Risk Ratings", we had an increase in loans classified as substandard of $163 million attributable to the downgrade of an electric distribution cooperative and its subsidiary as of May 31, 2018. The electric cooperative provides its customers with distribution and transmission services and is in the early stages of deploying retail broadband service. The borrower is currently experiencing financial difficulties due to recent net losses and weak cash flows. Pursuant to our risk rating guidelines, the borrower's current financial condition warranted a downgrade to a substandard rating as of May 31, 2018. The borrower and its subsidiary had loans outstanding of $165 million as of May 31, 2018, all but $7 million of which is secured under our typical collateral requirements for long-term loan advances. They are current with regard to all principal and interest payments and have never been delinquent. Because the borrower operates in a territory that is not rate-regulated, it has the ability to adjust its electric rates to cover operating costs and service debt. We currently expect to collect all principal and interest amounts due from them. Accordingly, the loans outstanding to this borrower and its subsidiary were not deemed to be impaired as of May 31, 2018.

See “MD&A—Critical Accounting Policies and Estimates—Allowance for Loan Losses” and “Note 1—Summary of Significa Accounting Policies” for information on the methodology for determining our allowance for loan losses and the key assumptions. See “Note 4—Loans” for additional information on the credit quality of our loan portfolio.

Counterparty Credit Risk

We are exposed to counterparty credit risk related to the performance of the parties with which we enter into financial transactions, primarily for derivative instruments, cash and time deposit accounts and our investment security holdings. To mitigate this risk, we only enter into these transactions with financial institutions with investment-grade ratings. Our cash and time deposits with financial institutions generally have an original maturity of less than one year.

We manage our derivative counterparty credit risk by requiring that derivative counterparties participate in one of our committed bank revolving line of credit agreements; monitoring the overall credit worthiness of each counterparty based on our internal counterparty credit risk scoring model; using counterparty-specific credit risk limits; executing master netting arrangements; and diversifying our derivative transactions among multiple counterparties. Our derivative counterparties had credit ratings ranging from Aa3 to Baa2 by Moody’s Investors Service (“Moody’s”) and from AA- to A- by S&P Global Inc. (“S&P”) as of May 31, 2018. Our largest counterparty exposure, based on the outstanding notional amount, represented approximately 24% and 23% of the total outstanding notional amount of derivatives as of May 31, 2018 and 2017, respectively.

Credit Risk-Related Contingent Features

Our derivative contracts typically contain mutual early-termination provisions, generally in the form of a credit rating trigger. Under the mutual credit rating trigger provisions, either counterparty may, but is not obligated to, terminate and settle the agreement if the credit rating of the other counterparty falls below a level specified in the agreement. If a derivative contract is terminated, the amount to be received or paid by us would be equal to the prevailing fair value, as defined in the agreement, as of the termination date.

Our senior unsecured credit ratings from Moody’s and S&P were A2 and A, respectively, as of May 31, 2018. Both Moody’s and S&P had our ratings on stable outlook as of May 31, 2018. Table 28 displays the notional amounts of our derivative contracts with rating triggers as of May 31, 2018, and the payments that would be required if the contracts were terminated as of that date because of a downgrade of our unsecured credit ratings or the counterparty’s unsecured credit ratings below A3/A-, below Baa1/BBB+ to or below Baa2/BBB, below Baa3/BBB- or to or below Ba2/BB+ by Moody’s or S&P, respectively. In calculating the payment amounts that would be required upon termination of the derivative contracts, we assumed that the amounts for each counterparty would be netted in accordance with the provisions of the counterparty’s master netting agreements. The net payment amounts are based on the fair value of the underlying derivative instrument, excluding the credit risk valuation adjustment, plus any unpaid accrued interest amounts.

Table 28: Rating Triggers for Derivatives

| (Dollars in thousands) | Notional Amount | Payable Due From CFC | Receivable Due to CFC | Net (Payable)/Receivable |
|---|---|---|---|---|
| Impact of rating downgrade trigger: | | | | |
| Falls below A3/A-[1] | $54,890 | $(9,355 ) | $ — | $ (9,355 ) |
| Falls below Baa1/BBB+ | 7,164,065 | (60,054 ) | 38,057 | (21,997 ) |
| Falls to or below Baa2/BBB [2] | 530,980 | — | 4,533 | 4,533 |
| Falls below Baa3/BBB- | 257,271 | (11,625 ) | — | (11,625 ) |
| Total | $8,007,206 | $(81,034) | $ 42,590 | $ (38,444 ) |

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(1) Rating trigger for CFC falls below A3/A-, while rating trigger for counterparty falls below Baa1/BBB+ by Moody's or S&P, respectively.
(2) Rating trigger for CFC falls to or below Baa2/BBB, while rating trigger for counterparty falls to or below Ba2/BB+ by Moody's or S&P, respectively.

On March 30, 2018, the master swap agreement with one of our counterparties was amended to include a ratings trigger and early termination provision based on a downgrade of CFC's senior unsecured credit ratings below Baa3, BBB- or BBB- by Moody's, S&P or Fitch, respectively, for any future swap transaction entered into under the agreement. We have outstanding

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notional amount of derivatives with this counterparty subject to this rating trigger, which is not included in the above table, totaling $200 million as of May 31, 2018. These contracts were in a loss position of $1 million as of May 31, 2018.

The aggregate fair value amount, including the credit valuation adjustment, of all interest rate swaps with rating triggers that were in a net liability position was $81 million as of May 31, 2018. There were no counterparties that fell below the rating trigger levels in our interest swap contracts as of May 31, 2018. If a counterparty has a credit rating that falls below the rating trigger level specified in the interest swap contract, we have the option to terminate all derivatives with the counterparty. However, we generally do not terminate such agreements prematurely because our interest rate swaps are critical to our matched funding strategy to mitigate interest rate risk.

See “Item 1A. Risk Factors” for additional information about credit risk related to our business.

LIQUIDITY RISK

We consider liquidity to be the ability to access funding or convert assets to cash quickly and efficiently, or to rollover or issue new debt, both under normal operating conditions and under periods of market stress, at a reasonable cost to ensure that we can meet borrower loan requests and other short-term cash obligations.

Liquidity Risk Management

Our liquidity risk-management framework is designed to meet our liquidity objectives of providing a reliable source of funding to members, meet maturing debt and other financial obligations, issue new debt and fund our operations on a cost-effective basis under normal operating conditions as well as under CFC-specific and/or market stress conditions. We engage in various activities to manage liquidity risk and achieve our liquidity objectives. Our Asset Liability Committee establishes guidelines that are intended to ensure that we maintain sufficient, diversified sources of liquidity to cover potential funding requirements as well as unanticipated contingencies. Our Treasury group develops strategies to manage our targeted liquidity position, projects our funding needs under various scenarios, including adverse circumstances, and monitors our liquidity position on an ongoing basis.

Liquidity Reserve

As part of our strategy in meeting our liquidity objectives, we seek to maintain access to liquidity in the form of both on-balance sheet and off-balance sheet funding sources that are readily accessible for immediate liquidity needs. Table 29 below presents the components of our liquidity reserve and a comparison of the amounts available as of May 31, 2018 and 2017.

Table 29: Liquidity Reserve

| | May 31, 2018 | | | 2017 | | |
|---|---|---|---|---|---|---|
| (Dollars in millions) | Total | Accessed | Available | Total | Accessed | Available |
| Cash and cash equivalents | $231 | $— | $ 231 | $167 | $— | $ 167 |
| Committed bank revolving line of credit agreements—unsecured[1] | 3,085 | 3 | 3,082 | 3,165 | 1 | 3,164 |
| Guaranteed Underwriter Program committed facilities—secured[2] | 6,548 | 5,323 | 1,225 | 5,798 | 5,073 | 725 |
| Farmer Mac revolving note purchase agreement, dated March 24, 2011, as amended—secured[3] | 5,200 | 2,791 | 2,409 | 4,500 | 2,513 | 1,987 |
| Farmer Mac revolving note purchase agreement, dated July 31, 2015, as amended—secured | 300 | 100 | 200 | 300 | — | 300 |
| Total | $15,364 | $ 8,217 | $ 7,147 | $13,930 | $ 7,587 | $ 6,343 |

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[(1)]The accessed amount of $3 million and $1 million as of May 31, 2018 and May 31, 2017, respectively, relates to letters of credit issued pursuant to the

five-year line of credit agreement.
(2)The committed facilities under the Guaranteed Underwriter Program are not revolving.
(3)Availability subject to market conditions.

Borrowing Capacity

In addition to cash, our liquidity reserve includes access to funds under committed revolving line of credit agreements with banks, committed loan facilities under the Guaranteed Underwriter Program and our revolving note purchase agreements with Farmer Mac. Following is a discussion of our borrowing capacity and key terms and conditions under each of these facilities.

Committed Bank Revolving Line of Credit Agreements—Unsecured

Our committed bank revolving lines of credit may be used for general corporate purposes; however, we generally rely on them as a backup source of liquidity for our member and dealer commercial paper. We had $3,085 million of commitments under committed bank revolving line of credit agreements as of May 31, 2018. Under our current committed bank revolving line of credit agreements, we have the ability to request up to $300 million of letters of credit, which would result in a reduction in the remaining available amount under the facilities.

On November 20, 2017, we amended and restated the three-year and five-year committed bank revolving line of credit agreements to extend the maturity dates to November 20, 2020 and November 20, 2022, respectively, and to terminate certain third-party bank commitments totaling $40 million under the three-year agreement and $40 million under the five- year agreement. As a result, the total commitment amount from third parties under the three-year facility and the five-year facility is $1,493 million and $1,592 million, respectively, resulting in a combined total commitment amount under the two facilities of $3,085 million.

Table 30 presents the total commitment, the net amount available for use and the outstanding letters of credit under our committed bank revolving line of credit agreements as of May 31, 2018. We did not have any outstanding borrowings under our bank revolving line of credit agreements as of May 31, 2018.

Table 30: Committed Bank Revolving Line of Credit Agreements

| | May 31, 2018 | | | | |
|---|---|---|---|---|---|
| (Dollars in millions) | Total Commitment | Letters of Credit Outstanding | Net Available for Advance | Maturity | Annual Facility Fee (1) |
| 3-year agreement | $1,492 | $ — | $ 1,492 | November 20, 2020 | 7.5 bps |
| 5-year agreement | 1,593 | 3 | 1,590 | November 20, 2022 | 10 bps |
| Total | $3,085 | $ 3 | $ 3,082 | | |

(1)Facility fee based on CFC's senior unsecured credit ratings in accordance with the established pricing schedules at the inception of the related agreement.

Our committed bank revolving line of credit agreements do not contain a material adverse change clause or rating triggers that would limit the banks' obligations to provide funding under the terms of the agreements; however, we must be in compliance with the covenants to draw on the facilities. We have been and expect to continue to be in compliance with the covenants under our committed bank revolving line of credit agreements. As such, we could draw on these facilities to repay dealer or member commercial paper that cannot be rolled over. See "Financial Ratios" and

"Debt Covenants" below for additional information, including the specific financial ratio requirements under our committed bank revolving line of credit agreements.

Guaranteed Underwriter Program Committed Facilities—Secured

Under the Guaranteed Underwriter Program, we can borrow from the Federal Financing Bank and use the proceeds to refinance existing indebtedness. As part of the program, we pay fees, based on outstanding borrowings, that support the USDA Rural Economic Development Loan and Grant program. The borrowings under this program are guaranteed by RUS.

On November 9, 2017, we closed on a $750 million committed loan facility ("Series M") from the Federal Financing Bank under the Guaranteed Underwriter Program. Pursuant to this facility, we may borrow any time before July 15, 2022. Each advance is subject to quarterly amortization and a final maturity not longer than 20 years from the advance date. The closing of this committed loan facility increased the amount available for access under the Guaranteed Underwriter Program to $1,225 million as of May 31, 2018. Of this amount, $100 million is available for advance through January 15, 2019, $375 million is available for advance through October 15, 2019 and $750 million is available through July 15, 2022.

We are required to pledge eligible distribution system or power supply system loans as collateral in an amount at least equal to the total outstanding borrowings under the Guaranteed Underwriter Program. See "Consolidated Balance Sheet Analysis—Debt—Collateral Pledged" and "Note 4—Loans" for additional information on pledged collateral.

Farmer Mac Revolving Note Purchase Agreements—Secured

As indicated in Table 29, we have two revolving note purchase agreements with Farmer Mac, which together allow us to borrow up to $5,500 million from Farmer Mac. On February 26, 2018, we amended our first revolving note purchase agreement with Farmer Mac dated March 24, 2011. Under the amended agreement, we can borrow, subject to market conditions, up to $5,200 million at any time through January 11, 2022, and such date shall automatically extend on each anniversary date of the closing for an additional year, unless prior to any such anniversary date, Farmer Mac provides us with a notice that the draw period will not be extended beyond the remaining term. This revolving note purchase agreement allows us to borrow, repay and re-borrow funds at any time through maturity, as market conditions permit, provided that the outstanding principal amount at any time does not exceed the total available under the agreement. Each borrowing under the note purchase agreement is evidenced by a pricing agreement setting forth the interest rate, maturity date and other related terms as we may negotiate with Farmer Mac at the time of each such borrowing. We may select a fixed rate or variable rate at the time of each advance with a maturity as determined in the applicable pricing agreement. We had outstanding secured notes payable totaling $2,791 million and $2,513 million as of May 31, 2018 and 2017, respectively, under the Farmer Mac revolving note purchase agreement of $5,200 million. The available borrowing amount totaled $2,409 million as of May 31, 2018.

Under the terms of the second revolving note purchase agreement with Farmer Mac dated July 31, 2015, we can borrow up to $300 million at any time through July 31, 2018 at a fixed spread over LIBOR. This agreement also allows us to borrow, repay and re-borrow funds at any time through maturity, provided that the outstanding principal amount at any time does not exceed the total available under the agreement. We had outstanding borrowings of $100 million as of May 31, 2018 under this revolving note purchase agreement with Farmer Mac. This advance was repaid in full subsequent to May 31, 2018. The available borrowing amount totaled $200 million as of May 31, 2018. We had no notes payable outstanding under this revolving note purchase agreement with Farmer Mac as of May 31, 2017. The second revolving note purchase agreement with Farmer Mac was amended effective July 31, 2018 to extended the maturity to December 20, 2023. Prior to the maturity date, Farmer Mac may terminate the agreement on periodic facility renewal dates set forth in the agreement upon 30 days written notice to us. We may terminate the agreement upon 30 days written notice at any time.

Pursuant to both Farmer Mac revolving note purchase agreements, we are required to pledge eligible distribution system or power supply system loans as collateral in an amount at least equal to the total principal amount of notes outstanding. See "Consolidated Balance Sheet Analysis—Debt—Collateral Pledged" and "Note 4—Loans" for additional information on pledged collateral.

Short-Term Borrowings

We rely on short-term borrowings, which we refer to as our short-term funding portfolio, as a source to meet our daily, near-term funding needs. Our short-term funding portfolio consists of commercial paper, which we offer to members and dealers, select notes and daily liquidity fund notes offered to members, and bank-bid notes and medium-term notes offered to members and dealers. Table 31 displays the composition of our short-term borrowings, by funding source, as of May 31, 2018 and 2017.

Table 31: Short-Term Borrowings—Funding Sources

| | May 31, 2018 | | 2017 | |
|---|---|---|---|---|
| (Dollars in thousands) | Outstanding Amount | % of Total Short-Term Borrowings | Outstanding Amount | % of Total Short-Term Borrowings |
| Funding source: | | | | |
| Members | $2,631,644 | 69 % | $2,343,209 | 70 % |
| Capital markets | 1,164,266 | 31 | 999,691 | 30 |
| Total short-term borrowings | $3,795,910 | 100 % | $3,342,900 | 100 % |

Table 32 displays additional information on our short-term borrowings, including the maximum month-end and average outstanding amounts, the weighted average interest rate and the weighted average maturity, for each respective category of our short-term borrowings for fiscal years 2018, 2017 and 2016.

Table 32: Short-Term Borrowings

| | May 31, 2018 | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | Amount Outstanding | Weighted-Average Interest Rate | Weighted-Average Maturity | Maximum Month-End Outstanding Amount | Average Outstanding Amount |
| Short-term borrowings: | | | | | |
| Commercial paper: | | | | | |
| Commercial paper to dealers, net of discounts | $1,064,266 | 1.87 % | 14 days | $2,548,147 | $942,931 |
| Commercial paper to members, at par | 1,202,105 | 1.89 | 34 days | 1,268,515 | 1,005,624 |
| Total commercial paper | 2,266,371 | 1.88 | 25 days | 3,447,274 | 1,948,555 |
| Select notes to members | 780,472 | 2.04 | 44 days | 780,472 | 727,313 |
| Daily liquidity fund notes to members | 400,635 | 1.50 | 1 day | 866,065 | 618,705 |
| Medium-term notes sold to members | 248,432 | 1.90 | 150 days | 248,432 | 217,122 |
| Farmer Mac revolving facility | 100,000 | 2.23 | 61 days | 100,000 | 548 |
| Total short-term borrowings | $3,795,910 | 1.88 | 35 days | | $3,512,243 |

| | May 31, 2017 | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | Amount Outstanding | Weighted-Average Interest Rate | Weighted-Average Maturity | Maximum Month-End Outstanding Amount | Average Outstanding Amount |
| Short-term borrowings: | | | | | |
| Commercial paper: | | | | | |
| Commercial paper to dealers, net of discounts | $999,691 | 0.93 % | 13 days | $2,048,954 | $988,538 |
| Commercial paper to members, at par | 928,158 | 0.95 | 24 days | 1,080,737 | 928,082 |
| Total commercial paper | 1,927,849 | 0.94 | 18 days | 3,006,148 | 1,916,620 |
| Select notes | 696,889 | 1.12 | 43 days | 840,990 | 726,276 |
| Daily liquidity fund notes | 527,990 | 0.80 | 1 day | 687,807 | 542,188 |
| Medium-term notes sold to members | 190,172 | 1.50 | 144 days | 203,246 | 194,045 |
| Total short-term borrowings | $3,342,900 | 0.99 | 28 days | | $3,379,129 |

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| (Dollars in thousands) | May 31, 2016 Amount Outstanding | Weighted-Average Interest Rate | | Weighted-Average Maturity | Maximum Month-End Outstanding Amount | Average Outstanding Amount |
|---|---|---|---|---|---|---|
| Short-term borrowings: | | | | | | |
| Commercial paper: | | | | | | |
| Commercial paper to dealers, net of discounts | $659,935 | 0.43 | % | 24 days | $1,639,835 | $944,928 |
| Commercial paper to members, at par | 848,007 | 0.45 | | 9 days | 1,001,361 | 789,723 |
| Total commercial paper | 1,507,942 | 0.44 | | 17 days | 2,445,894 | 1,734,651 |
| Select notes | 701,849 | 0.62 | | 43 days | 845,805 | 709,285 |
| Daily liquidity fund notes | 525,959 | 0.34 | | 1 day | 740,142 | 551,594 |
| Medium-term notes sold to members | 203,098 | 1.05 | | 161 days | 213,260 | 199,078 |
| Total short-term borrowings | $2,938,848 | 0.51 | | 31 days | | $3,194,608 |

Our short-term borrowings totaled $3,796 million and accounted for 15% of total debt outstanding as of May 31, 2018, compared with $3,343 million, or 14%, of total debt outstanding as of May 31, 2017. The weighted-average maturity and weighted-average cost of our short-term borrowings was 35 days and 1.88%, respectively, as of May 31, 2018, compared with 28 days and 0.99%, respectively, as of May 31, 2017. Of the total outstanding commercial paper, $1,064 million, or 4% of total debt outstanding, was issued to dealers as of May 31, 2018, compared with the $1,000 million, or 4% of total debt outstanding, that was issued to dealers as of May 31, 2017. Our intent is to manage our short-term wholesale funding risk by maintaining outstanding dealer commercial paper at an amount below $1,250 million for the foreseeable future. Member borrowings accounted for 69% of our total short-term borrowings as of May 31, 2018, compared with 70% of total short-term borrowings as of May 31, 2017.

Long-Term and Subordinated Debt

Long-term and subordinated debt represents the most significant component of our funding. The issuance of long-term debt allows us to reduce our reliance on short-term borrowings and effectively manage our refinancing and interest rate risk, due in part to the multi-year contractual maturity structure of long-term debt. In addition to access to private debt facilities, we also issue debt in the public capital markets. Pursuant to Rule 405 of the Securities Act, we are classified as a "well-known seasoned issuer." In November 2017, we filed a new shelf registration statement for our senior and subordinated debt securities under which we can register an unlimited amount of senior and subordinated debt securities, including medium-term notes, member capital securities and subordinated deferrable debt, until November 2020. Pursuant to our effective shelf registration statements filed with the SEC, we may offer and issue the following debt securities:

- an unlimited amount of collateral trust bonds until September 2019;
- an unlimited amount of senior and subordinated debt securities, including medium-term notes, member capital securities and subordinated deferrable debt, until November 2020; and
- daily liquidity fund notes up to $20,000 million in the aggregate—with a $3,000 million limit on the aggregate principal amount outstanding at any time—until March 2019.

Although we register member capital securities and the daily liquidity fund notes with the SEC, these securities are not available for sale to the general public. Medium-term notes are available for sale to both the general public and members.
Notwithstanding the foregoing, we have contractual limitations with respect to the amount of senior indebtedness we may incur.

As discussed in "Consolidated Balance Sheet Analysis—Debt," long-term and subordinated debt totaled $20,837 million and accounted for 85% of total debt outstanding as of May 31, 2018, compared with $20,117 million, or 86%, of total debt outstanding as of May 31, 2017. The increase in total debt outstanding, including long-term and subordinated debt, was primarily due to the issuance of debt to fund loan portfolio growth. Table 33 summarizes long-term and subordinated debt issuances and repayments during fiscal year 2018.

Table 33: Issuances and Repayments of Long-Term and Subordinated Debt[1]

| | Year Ended May 31, 2018 | | |
|---|---|---|---|
| (Dollars in thousands) | Issuances | Repayments [1] | Increase/(Decrease) |
| Long-term and subordinated debt activity:[2] | | | |
| Collateral trust bonds | $700,000 | $705,000 | $ (5,000) |
| Guaranteed Underwriter Program notes payable | 250,000 | 379,374 | (129,374) |
| Farmer Mac notes payable | 325,000 | 46,893 | 278,107 |
| Medium-term notes sold to members | 230,130 | 257,520 | (27,390) |
| Medium-term notes sold to dealers | 856,166 | 216,650 | 639,516 |
| Other notes payable | — | 5,565 | (5,565) |
| Members’ subordinated certificates | 6,136 | 45,180 | (39,044) |
| Total | $2,367,432 | $1,656,182 | $ 711,250 |

[1]Repayments include principal maturities, scheduled amortization payments, repurchases and redemptions.
[2]Amounts exclude unamortized debt issuance costs and discounts.

We provide additional information on our financing activities above under “Consolidated Balance Sheet Analysis—Debt” and on the weighted-average interest rates on our long-term debt and subordinated certificates in “Note 6—Long-Term Debt”, “Note 7—Subordinated Deferrable Debt” and “Note 8—Members’ Subordinated Certificates”.

Investment Portfolio

In addition to our primary sources of liquidity discussed above, we have an investment portfolio, composed of time deposits, available-for-sale investment securities and held-to-maturity investment securities, which totaled $710 million and $319 million as of May 31, 2018 and 2017, respectively. We intend for our investment portfolio to remain adequately liquid to serve as a contingent supplemental source of liquidity for unanticipated liquidity needs.

During the second quarter of fiscal year 2018, we commenced the purchase of additional investment securities, consisting primarily of certificates of deposit, commercial paper, corporate debt securities, commercial mortgage-backed securities and other asset-backed securities. Pursuant to our investment policy and guidelines, all fixed-income securities, at the time of purchase, must be rated at least investment grade and on stable outlook based on external credit ratings from at least two of the leading global credit rating agencies, when available, or the corresponding equivalent, when not available. Securities rated investment grade, that is those rated Baa3 or higher by Moody’s or BBB- or higher by S&P, are generally considered by the rating agencies to be of lower credit risk than non-investment grade securities. We have the positive intent and ability to hold these securities to maturity. As such, we have classified them as held to maturity on our consolidated balance sheet.

Our investment portfolio is unencumbered and structured so that securities have active secondary or resale markets under normal market conditions. The objective of the portfolio is to achieve returns commensurate with the level of risk assumed subject to CFC’s investment policy and guidelines and liquidity requirements.

We provide additional information on available-for-sale and held-to-maturity investment securities held in our investment portfolio in “Note 3—Investment Securities.”

Projected Near-Term Sources and Uses of Liquidity

As discussed above, our primary sources of liquidity include cash flows from operations, short-term borrowings, our liquidity reserve and the issuance of long-term and subordinated debt, as well as loan principal and interest payments.

Our primary uses of liquidity include loan advances to members, principal and interest payments on borrowings, periodic settlement payments related to derivative contracts and operating expenses.

Table 34 below displays our projected sources and uses of cash, by quarter, over the next six quarters through the quarter ended November 30, 2019. Our projected liquidity position reflects our current plan to expand our investment portfolio. Our assumptions also include the following: (i) the estimated issuance of long-term debt, including collateral trust bonds and

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private placement of term debt, is based on maintaining a matched funding position within our loan portfolio with our bank revolving lines of credit serving as a backup liquidity facility for commercial paper and on maintaining outstanding dealer commercial paper at an amount below $1,250 million; (ii) long-term loan scheduled amortization payments represent the scheduled long-term loan payments for loans outstanding as of May 31, 2018, and our current estimate of long-term loan prepayments, which the amount and timing of are subject to change; (iii) other loan repayments and other loan advances primarily relate to line of credit repayments and advances; (iv) long-term debt maturities reflect scheduled maturities of outstanding term debt for the periods presented; and (v) long-term loan advances reflect our current estimate of member demand for loans, the amount and timing of which are subject to change.

Table 34: Projected Sources and Uses of Liquidity[1]

| | Projected Sources of Liquidity | | | | Projected Uses of Liquidity | | | | |
|---|---|---|---|---|---|---|---|---|---|
| (Dollars in millions) | Long-Term Debt Issuance | Anticipated Long-Term Loan Repayments[2] | Other Loan Repayments[3] | Total Projected Sources of Liquidity | Long-Term Debt Maturities[4] | Long-Term Loan Advances | Other Loan Advances[5] | Total Projected Uses of Liquidity | Other Sources/ (Uses) of Liquidity[6] |
| 1Q FY 2019 | $635 | $ 395 | $ — | $ 1,030 | $466 | $ 522 | $ 95 | $ 1,083 | $ (53) |
| 2Q FY 2019 | 1,350 | 317 | 55 | 1,722 | 1,301 | 446 | — | 1,747 | 38 |
| 3Q FY 2019 | 1,250 | 291 | — | 1,541 | 780 | 586 | — | 1,366 | (77) |
| 4Q FY 2019 | 400 | 320 | — | 720 | 477 | 304 | — | 781 | (52) |
| 1Q FY 2020 | 195 | 312 | — | 507 | 167 | 408 | — | 575 | 65 |
| 2Q FY 2020 | 700 | 281 | 55 | 1,036 | 678 | 396 | — | 1,074 | 24 |
| Total | $4,530 | $ 1,916 | $ 110 | $ 6,556 | $3,869 | $ 2,662 | $ 95 | $ 6,626 | $ (55) |

[1] The dates presented represent the end of each quarterly period through the quarter ended November 30, 2019.
[2] Anticipated long-term loan repayments include scheduled long-term loan amortizations, anticipated cash repayments at repricing date and sales.
[3] Other loan repayments include anticipated short-term loan repayments.
[4] Long-term debt maturities also includes medium-term notes with an original maturity of one year or less and expected early redemptions of debt.
[5] Other loan advances include anticipated short-term loan advances.
[6] Includes net increase or decrease to dealer commercial paper, and purchases and maturity of investments.

As displayed in Table 34, we currently project long-term advances of $1,858 million over the next 12 months, which we anticipate will exceed anticipated loan repayments over the same period by approximately $535 million. The estimates presented above are developed at a particular point in time based on our expected future business growth and funding. Our actual results and future estimates may vary, perhaps significantly, from the current projections, as a result of changes in market conditions, management actions or other factors.

Contractual Obligations

Our contractual obligations affect our short- and long-term liquidity needs. Table 35 displays aggregated information about the listed categories of our contractual obligations as of May 31, 2018. The table provides information on the contractual maturity profile of our debt securities based on undiscounted future cash payment amounts due pursuant to these obligations, aggregated by type of contractual obligation. The table excludes certain obligations where the obligation is short-term, such as trade payables, or where the amount is not fixed and determinable, such as derivatives subject to valuation based on market factors. The timing of actual future payments may differ from those presented due to a number of factors, such as discretionary debt redemptions or changes in interest rates that may impact our expected future cash interest payments.

Table 35: Contractual Obligations[1]

| (Dollars in millions) | 2019 | 2020 | 2021 | 2022 | 2023 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| Short-term borrowings | $3,796 | $— | $— | $— | $— | $ — | $3,796 |
| Long-term debt | 2,745 | 1,463 | 1,737 | 1,577 | 1,128 | 10,065 | 18,715 |
| Subordinated deferrable debt | — | — | — | — | — | 742 | 742 |
| Members' subordinated certificates[2] | 10 | 13 | 43 | 15 | 31 | 1,268 | 1,380 |
| Total long-term and subordinated debt | 2,755 | 1,476 | 1,780 | 1,592 | 1,159 | 12,075 | 20,837 |
| Contractual interest on long-term debt[3] | 642 | 565 | 524 | 484 | 439 | 4,767 | 7,421 |
| Total specified contractual obligations | $7,193 | $2,041 | $2,304 | $2,076 | $1,598 | $ 16,842 | $32,054 |

[1] Callable debt is included in this table at its contractual maturity.
[2] Excludes $0.3 million in subscribed and unissued member subordinated certificates for which a payment has been received, but no certificate has been issued. Amortizing member loan subordinated certificates totaling $274 million are amortizing annually based on the unpaid principal balance of the related loan. Amortization payments on these certificates totaled $16 million in fiscal year 2018 and represented 6% of amortizing loan subordinated certificates outstanding.
[3] Represents the amounts of future interest payments on long-term and subordinated debt outstanding as of May 31, 2018, based on the contractual terms of the securities. These amounts were determined based on certain assumptions, including that variable-rate debt continues to accrue interest at the contractual rates in effect as of May 31, 2018 until maturity and redeemable debt continues to accrue interest until its contractual maturity.

Credit Ratings

Our funding and liquidity, borrowing capacity, ability to access capital markets and other sources of funds and the cost of these funds are partially dependent on our credit ratings. Rating agencies base their ratings on numerous factors, including liquidity, capital adequacy, industry position, member support, management, asset quality, quality of earnings and the probability of systemic support. Significant changes in these factors could result in different ratings. Table 36 displays our credit ratings as of May 31, 2018, which were unchanged as of the date of the filing of this Report.

Table 36: Credit Ratings

| | May 31, 2018 | | |
|---|---|---|---|
| | Moody's | S&P | Fitch |
| Long-term issuer credit rating[1] | A2 | A | A |
| Senior secured debt[2] | A1 | A | A+ |
| Senior unsecured debt[3] | A2 | A | A |
| Subordinated debt | A3 | BBB+ | BBB+ |
| Commercial paper | P-1 | A-1 | F1 |
| Outlook | Stable | Stable | Stable |

[1]Based on our senior unsecured debt rating.
[2]Applies to our collateral trust bonds.
[3]Applies to our medium-term notes.

During fiscal year 2018, Moody's, S&P and Fitch affirmed our ratings and outlook. In order to access the commercial paper markets at attractive rates, we believe we need to maintain our current commercial paper credit ratings of P-1 by Moody's, A-1 by S&P and F1 by Fitch. In addition, the notes payable to the Federal Financing Bank and guaranteed by RUS under the Guaranteed Underwriter Program contain a provision that if during any portion of the fiscal year, our senior secured credit ratings do not have at least two of the following ratings: (i) A3 or higher from Moody's, (ii) A- or higher from S&P, (iii) A- or higher from Fitch or (iv) an equivalent rating from a successor rating agency to any of the above rating agencies, we may not make cash patronage capital distributions in excess of 5% of total patronage capital. See "Credit Risk—Counterparty Credit Risk—Credit Risk-Related Contingent Features" above for information on credit rating provisions related to our derivative contracts.

Financial Ratios

Our debt-to-equity ratio decreased to 16.72-to-1 as of May 31, 2018, from 21.94-to-1 as of May 31, 2017, primarily due to an increase in equity resulting from our reported net income of $457 million for the year ended May 31, 2018, which was partially offset by patronage capital retirement of $45 million in September 2017.

Our adjusted debt-to-equity ratio increased to 6.18-to-1 as of May 31, 2018, from 5.95-to-1 as of May 31, 2017, largely due to an increase in debt outstanding to fund loan portfolio growth. We provide a reconciliation of our adjusted debt-to-equity ratio to the most comparable GAAP measure and an explanation of the adjustments below in "Non-GAAP Financial Measures."

Debt Covenants

As part of our short-term and long-term borrowing arrangements, we are subject to various financial and operational covenants. If we fail to maintain specified financial ratios, such failure could constitute a default by CFC of certain debt covenants under our committed bank revolving line of credit agreements and senior debt indentures. We were in compliance with all covenants and conditions under our committed bank revolving line of credit agreements and senior debt indentures as of May 31, 2018.

As discussed above in "Item 6—Selected Financial Data," the financial covenants set forth in our committed bank revolving line of credit agreements and senior debt indentures are based on adjusted financial measures, including adjusted TIER. We provide a reconciliation of adjusted TIER and other non-GAAP measures disclosed in this report to the most comparable GAAP measures and an explanation of the adjustments below in "Non-GAAP Financial Measures."

MARKET RISK

Interest rate risk represents our primary source of market risk. Interest rate risk is the risk to current or anticipated earnings or equity arising primarily from movements in interest rates. This risk results from differences between the timing of cash flows on our assets due to contractual maturities, re-pricing characteristics and prepayments and the liabilities funding those assets.

Interest Rate Risk Management

Our interest rate risk exposure is primarily related to the funding of the fixed-rate loan portfolio. Our Asset Liability Committee provides oversight for maintaining our interest rate position within a prescribed policy range using approved strategies. The Asset Liability Committee reviews a complete interest rate risk analysis, reviews proposed modifications, if any, to our interest rate risk management strategy and considers adopting strategy changes. Our Asset Liability Committee monitors interest rate risk and meets quarterly to review and discuss information such as national economic forecasts, federal funds and interest rate forecasts, interest rate gap analysis, our liquidity position, loan and debt maturities, short-term and long-term funding needs, anticipated loan demands, credit concentration risk, derivative counterparty exposure and financial forecasts. The Asset Liability Committee also discusses the composition of fixed-rate versus variable-rate loans, new funding opportunities, changes to the nature and mix of assets and liabilities for structural mismatches, and interest rate swap transactions.

Matched Funding Objective

Our funding objective is to manage the matched funding of asset and liability repricing terms within a range of adjusted total assets (calculated by excluding derivative assets from total assets) deemed appropriate by the Asset Liability Committee based on the current environment and extended outlook for interest rates. We refer to the difference between fixed-rate loans scheduled for amortization or repricing and the fixed-rate liabilities and equity funding those loans as our interest rate gap. Our primary strategies for managing our interest rate risk include the use of derivatives and limiting the amount of fixed-rate assets that can be funded by variable-rate debt to a specified percentage of adjusted total assets based on market conditions.

We provide our members with many options on loans with regard to interest rates, the term for which the selected interest rate is in effect and the ability to convert or prepay the loan. Long-term loans generally have maturities of up to 35 years.

Borrowers may select fixed interest rates for periods of one year through the life of the loan. We do not match fund the majority of our fixed-rate loans with a specific debt issuance at the time the loans are advanced. We fund the amount of fixed-rate assets that exceed fixed-rate debt and members' equity with short-term debt, primarily commercial paper.

Interest Rate Gap Analysis

To monitor and mitigate interest rate risk in the funding of fixed-rate loans, we perform a monthly interest rate gap analysis that provides a comparison between fixed-rate assets repricing or maturing by year and fixed-rate liabilities and members' equity maturing by year.

We maintain an unmatched position on our fixed-rate assets within a targeted range of adjusted total assets. The limited unmatched position is intended to provide flexibility to ensure that we are able to match the current maturing portion of long-term fixed-rate loans based on maturity date and the opportunity in the current low interest rate environment to increase the gross yield on our fixed-rate assets without taking what we would consider to be excessive risk.

Table 37 displays the scheduled amortization and repricing of fixed-rate assets and liabilities outstanding as of May 31, 2018. We exclude variable-rate loans from our interest rate gap analysis as we do not consider the interest rate risk on these loans to be significant because they are subject to repricing at least monthly. Loans with variable interest rates accounted for 10% and 9% of our total loan portfolio as of May 31, 2018 and 2017, respectively. Fixed-rate liabilities include debt issued at a fixed rate as well as variable-rate debt swapped to a fixed rate using interest rate swaps. Fixed-rate debt swapped to a variable rate using interest rate swaps is excluded from the analysis since it is used to match fund the variable-rate loan pool. With the exception of members' subordinated certificates, which are generally issued with extended maturities, and commercial paper, our liabilities have average maturities that closely match the repricing terms (but not the maturities) of our fixed-rate loans.

Table 37: Interest Rate Gap Analysis

| (Dollars in millions) | Prior to 5/31/19 | Two Years 6/1/19 to 5/31/21 | Two Years 6/1/21 to 5/31/23 | Five Years 6/1/23 to 5/31/28 | 10 Years 6/1/28 to 5/31/38 | 6/1/38 and Thereafter | Total |
|---|---|---|---|---|---|---|---|
| Asset amortization and repricing | $1,870 | $3,239 | $2,958 | $5,531 | $6,549 | $2,937 | $23,084 |
| Liabilities and members' equity: | | | | | | | |
| Long-term debt [1] | $2,500 | $3,107 | $2,421 | $5,610 | $4,523 | $1,147 | $19,308 |
| Subordinated certificates | 16 | 52 | 48 | 977 | 154 | 578 | 1,825 |
| Members' equity [2] | 48 | 23 | 24 | 105 | 293 | 875 | 1,368 |
| Total liabilities and members' equity [3] | $2,564 | $3,182 | $2,493 | $6,692 | $4,970 | $2,600 | $22,501 |
| Gap [4] | $(694) | $57 | $465 | $(1,161) | $1,579 | $337 | $583 |
| Cumulative gap | (694) | (637) | (172) | (1,333) | 246 | 583 | |
| Cumulative gap as a % of total assets | (2.60)% | (2.39)% | (0.64)% | (4.99)% | 0.92% | 2.18% | |
| Cumulative gap as a % of adjusted total assets [5] | (2.62) | (2.41) | (0.65) | (5.04) | 0.93 | 2.20 | |

[1] Includes long-term fixed-rate debt and net fixed-rate swaps.
[2] Includes the portion of the allowance for loan losses and subordinated deferrable debt allocated to fund fixed-rate assets and excludes noncash adjustments from the accounting for derivative financial instruments.
[3] Debt is presented based on call date.
[4] Calculated based on the amount of assets amortizing and repricing less total liabilities and members' equity.

(5)Adjusted total assets represents total assets reported in our consolidated balance sheets less derivative assets.

The difference, or interest rate gap, of $583 million between the fixed-rate loans scheduled for amortization or repricing of $23,084 million and the fixed-rate liabilities and equity funding the loans of $22,501 million presented in Table 37 reflects the amount of fixed-rate assets that are funded with short-term and variable-rate debt as of May 31, 2018. The gap of $583 million represented 2.18% of total assets and 2.20% of adjusted total assets (total assets excluding derivative assets) as of

May 31, 2018. As discussed above, we manage this gap within a prescribed range because funding long-term, fixed-rate loans with short-term and variable-rate debt may expose us to higher interest rate and liquidity risk.

Financial Instruments

Table 38 provides information about our financial instruments, other than derivatives, that are sensitive to changes in interest rates. We provide additional information on our use of derivatives and exposure in "Note 1—Summary of Significant Accounting Policies—Derivative Instruments" and "Note 9—Derivative Instruments and Hedging Activities." All of our financial instruments as of May 31, 2018 were entered into or contracted for purposes other than trading. For debt obligations, the table presents principal cash flows and related average interest rates by expected maturity dates as of May 31, 2018.

Table 38: Financial Instruments

| | | | Principal Amortization and Maturities | | | | | |
|---|---|---|---|---|---|---|---|---|
| (Dollars in millions) | Outstanding Balance | Fair Value | 2019 | 2020 | 2021 | 2022 | 2023 | Remaining Years |
| Assets: | | | | | | | | |
| Time deposits | $ 101 | $ 101 | $ 101 | $— | $— | $— | $— | $— |
| Investment securities, available for sale | $ 89 | $ 89 | $— | $— | $— | $— | $— | $ 89 |
| Investment securities, held to maturity | $ 520 | $ 516 | $ 23 | $ 59 | $ 101 | $ 113 | $ 141 | $ 83 |
| Average rate | 2.91 % | | 1.81 % | 2.43 % | 2.79 % | 2.96 % | 2.96 % | 3.56 % |
| Long-term fixed-rate loans [1] | $ 22,696 | $ 21,714 | $ 1,132 | $ 1,168 | $ 1,169 | $ 1,148 | $ 1,157 | $ 16,922 |
| Average rate | 4.60 % | | 4.33 % | 4.40 % | 4.43 % | 4.48 % | 4.54 % | 4.66 % |
| Long-term variable-rate loans | $ 1,039 | $ 1,039 | $ 95 | $ 77 | $ 53 | $ 49 | $ 43 | $ 722 |
| Average rate | 3.39 % | | — | — | — | — | — | — |
| Line of credit loans | $ 1,432 | $ 1,432 | $ 1,432 | $— | $— | $— | $— | $— |
| Average rate | 3.09 % | | 3.09 % | — | — | — | — | — |
| Liabilities and equity: | | | | | | | | |
| Short-term borrowings [2] | $ 3,796 | $ 3,796 | $ 3,796 | $— | $— | $— | $— | $— |
| Average rate | 1.88 % | | 1.88 % | — | — | — | — | — |
| Long-term debt | $ 18,715 | $ 18,909 | $ 2,745 | $ 1,463 | $ 1,737 | $ 1,577 | $ 1,128 | $ 10,065 |
| Average rate | 3.39 % | | 5.47 % | 2.24 % | 2.64 % | 2.79 % | 2.67 % | 3.30 % |
| Subordinated deferrable debt | $ 742 | $ 766 | $— | $— | $— | $— | $— | $ 742 |
| Average rate | 4.98 % | | — | — | — | — | — | 4.98 % |
| Members' subordinated certificates [3] | $ 1,380 | $ 1,380 | $ 10 | $ 13 | $ 43 | $ 15 | $ 31 | $ 1,268 |
| Average rate | 4.18 % | | 2.82 % | 2.85 % | 3.64 % | 2.92 % | 2.70 % | 4.27 % |

[1] The principal amount of fixed-rate loans is the total of scheduled principal amortizations without consideration for loans that reprice. Includes $13 million in TDR loans that were on accrual status as of May 31, 2018.
[2] Short-term borrowings includes commercial paper, select notes, daily liquidity fund notes, bank bid notes and medium-term notes issued with an original maturity of one year or less.
[3] Excludes $0.3 million in subscribed and unissued member subordinated certificates for which a payment has been received, but no certificate has been issued. Amortizing member loan subordinated certificates totaling $274 million are amortizing annually based on the unpaid principal balance of the related loan. Amortization payments on these certificates totaled $16 million in fiscal year 2018 and amortization represented 6% of amortizing loan subordinated certificates outstanding.

Loan Repricing

Table 39 shows long-term fixed-rate loans outstanding as of May 31, 2018, which will be subject to interest rate repricing during the next five fiscal years and thereafter (due to principal repayments, amounts subject to interest rate repricing may be lower at the actual time of interest rate repricing).

Table 39: Loan Repricing

| (Dollars in thousands) | Repricing Amount | Weighted-Average Interest Rate | |
|---|---|---|---|
| 2019 | $756,283 | 4.48 | % |
| 2020 | 521,833 | 4.66 | |
| 2021 | 430,680 | 4.43 | |
| 2022 | 393,109 | 4.66 | |
| 2023 | 328,004 | 4.93 | |
| Thereafter | 1,346,704 | 5.07 | |
| Total | $3,776,613 | | |

OPERATIONAL RISK

Operational risk represents the risk of loss resulting from conducting our operations, including, but not limited to, the execution of unauthorized transactions by employees; errors relating to loan documentation, transaction processing and technology; the inability to perfect liens on collateral; breaches of internal control and information systems; and the risk of fraud by employees or persons outside the company. This risk of loss also includes potential legal actions that could arise as a result of operational deficiencies, noncompliance with covenants in our revolving credit agreements and indentures, employee misconduct or adverse business decisions. In the event of a breakdown in internal controls, improper access to or operation of systems or improper employee actions, we could incur financial loss. Operational/business risk may also include breaches of our technology and information systems resulting from unauthorized access to confidential information or from internal or external threats, such as cyberattacks.

Operational risk is inherent in all business activities. The management of such risk is important to the achievement of our objectives. We maintain business policies and procedures, employee training, an internal control framework, and a comprehensive business continuity and disaster recovery plan that are intended to provide a sound operational environment. Our business policies and controls have been designed to manage operational risk at appropriate levels given our financial strength, the business environment and markets in which we operate, the nature of our businesses, and considering factors such as competition and regulation. Our Corporate Compliance group monitors compliance with established procedures that are designed to ensure adherence to generally accepted conduct, ethics and business practices defined in our corporate policies. We provide employee compliance training programs, including information protection, suspicious activity reporting and operational risk. Our Internal Audit group examines the design and operating effectiveness of our operational, compliance and financial reporting internal controls on an ongoing basis.

Our business continuity and disaster recovery plan establishes the basic principles and framework necessary to ensure emergency response, resumption, restoration and permanent recovery of CFC's operations and business activities during a business interruption event. This plan includes a duplication of our operating systems at an offsite facility coupled with an extensive business continuity and recovery process to leverage those remote systems. Each of our departments is required to develop, exercise, test and maintain business resumption plans for the recovery of business functions and processing resources to minimize disruption for our members and other parties with whom we do business. We conduct disaster recovery exercises periodically that include both the information technology group and business areas. The business resumption plans are based on a risk assessment that considers potential losses due to unavailability of service versus the cost of resumption. These plans anticipate a variety of probable scenarios ranging from local to regional crises.

As cyber-related attacks could materially affect our operations, our board of directors places particular emphasis on the oversight of cybersecurity risks. At each regularly scheduled board of directors meeting, or more frequently as requested by the board of directors, management provides reports on CFC's security operations, including any cybersecurity incidents, management's efforts to manage any incidents, and any other information requested from management. On at least an annual basis, the board of directors reviews management reports concerning the disclosure controls and procedures in place to enable CFC to make accurate and timely disclosures about any material cybersecurity events. Additionally, upon the occurrence of a material cybersecurity incident, the board of directors will be notified of the event so it may properly evaluate such incident, including management’s remediation plan.

NON-GAAP FINANCIAL MEASURES

In addition to financial measures determined in accordance with GAAP, management evaluates performance based on certain non-GAAP measures, which we refer to as “adjusted” measures. Below we provide a discussion of each of these non-GAAP measures and provide a reconciliation of our adjusted measures to the most comparable GAAP measures in this section. We believe our non-GAAP adjusted metrics, which are not a substitute for GAAP and may not be consistent with similarly titled non-GAAP measures used by other companies, provide meaningful information and are useful to investors because management uses these metrics to compare operating results across financial reporting periods, for internal budgeting and forecasting purposes, for compensation decisions and for short- and long-term strategic planning decisions. In addition, certain of the financial covenants in our committed bank revolving line of credit agreements and debt indentures are based on our adjusted measures.

Statements of Operations Non-GAAP Adjustments

Our primary performance measure is TIER. TIER is calculated by adding the interest expense to net income prior to the cumulative effect of change in accounting principle and dividing that total by the interest expense. TIER is a measure of our ability to cover interest expense requirements on our debt. We adjust the TIER calculation to add the derivative cash settlements to the interest expense and to remove the derivative forward value gains (losses) and foreign currency adjustments from total net income. Adding cash settlements back to interest expense also has a corresponding effect on our adjusted net interest income.

We use derivatives to manage interest rate risk on our funding of the loan portfolio. The derivative cash settlements represent the amount that we receive from or pay to our counterparties based on the interest rate indexes in our derivatives that do not qualify for hedge accounting. We adjust the reported interest expense to include the derivative cash settlements. We use the adjusted cost of funding to set interest rates on loans to our members and believe that the interest expense adjusted to include derivative cash settlements represents our total cost of funding for the period. TIER calculated by adding the derivative cash settlements to the interest expense reflects management’s perspective on our operations and, therefore, we believe that it represents a useful financial measure for investors.

The derivative forward value gains (losses) and foreign currency adjustments do not represent our cash inflows or outflows during the current period and, therefore, do not affect our current ability to cover our debt service obligations. The derivative forward value gains (losses) included in the derivative gains (losses) line of the statement of operations represents a present value estimate of the future cash inflows or outflows that will be recognized as net cash settlements for all periods through the maturity of our derivatives that do not qualify for hedge accounting. We have not issued foreign-denominated debt since 2007, and as of May 31, 2018 and 2017, there were no foreign currency derivative instruments outstanding.

For operational management and decision-making purposes, we subtract derivative forward value gains (losses) and foreign currency adjustments from our net income when calculating TIER and for other net income presentation purposes. In addition, since the derivative forward value gains (losses) and foreign currency adjustments do not represent current period cash flows, we do not allocate such funds to our members and, therefore, exclude the derivative forward value gains (losses) and foreign currency adjustments from net income in calculating the amount of net income to be allocated to our members. TIER calculated by excluding the derivative forward value gains (losses) and foreign currency adjustments from net income reflects management’s perspective on our operations and, therefore, we believe that it represents a useful financial measure for investors.

Total equity includes the noncash impact of derivative forward value gains (losses) and foreign currency adjustments recorded in net income. It also includes as a component of accumulated other comprehensive income the impact of changes in the fair value of derivatives designated as cash flow hedges as well as the remaining transition adjustment recorded when we adopted the accounting guidance that required all derivatives be recorded on the balance sheet at fair value. In evaluating our debt-to-equity ratio discussed further below, we make adjustments to equity similar to the adjustments made in calculating TIER. We exclude from total equity the cumulative impact of changes in derivative forward value gains (losses) and foreign currency adjustments and amounts included in accumulated other comprehensive income related to derivatives designated for cash flow hedge accounting and the remaining derivative transition adjustment to derive non-GAAP adjusted equity.

Table 40 provides a reconciliation of adjusted interest expense, adjusted net interest income and adjusted net income to the comparable GAAP measures. The adjusted amounts are used in the calculation of our adjusted net interest yield and adjusted TIER for fiscal years 2018, 2017, 2016, 2015 and 2014.

Table 40: Adjusted Financial Measures — Income Statement

| | Year Ended May 31, | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2016 | 2015 | 2014 |
| Interest expense | $(792,735) | $(741,738) | $(681,850) | $(635,684) | $(654,655) |
| Include: Derivative cash settlements | (74,281) | (84,478) | (88,758) | (82,906) | (73,962) |
| Adjusted interest expense | $(867,016) | $(826,216) | $(770,608) | $(718,590) | $(728,617) |
| | | | | | |
| Net interest income | $284,622 | $294,896 | $330,786 | $317,292 | $302,885 |
| Include: Derivative cash settlements | (74,281) | (84,478) | (88,758) | (82,906) | (73,962) |
| Adjusted net interest income | $210,341 | $210,418 | $242,028 | $234,386 | $228,923 |
| | | | | | |
| Net income (loss) | $457,364 | $312,099 | $(51,516) | $(18,927) | $192,926 |
| Exclude: Derivative forward value gains (losses) | 306,002 | 179,381 | (221,083) | (114,093) | 39,541 |
| Adjusted net income | $151,362 | $132,718 | $169,567 | $95,166 | $153,385 |

We consider the cost of derivatives to be an inherent cost of funding and hedging our loan portfolio and, therefore, economically similar to the interest expense that we recognize on debt issued for funding. We therefore include derivative cash settlements in our adjusted interest expense and exclude the unrealized forward value of derivatives from our adjusted net income.

TIER and Adjusted TIER

Table 41 presents our TIER and adjusted TIER for the years ended May 2018, 2017, 2016, 2015 and 2014.

Table 41: TIER and Adjusted TIER

| | Year Ended May 31, | | | | |
|---|---|---|---|---|---|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| TIER [(1)] | 1.58 | 1.42 | 0.92 | 0.97 | 1.29 |
| Adjusted TIER [(2)] | 1.17 | 1.16 | 1.22 | 1.13 | 1.21 |

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[(1)] TIER is calculated based on net income plus interest expense for the period divided by interest expense for the period.
[(2)] Adjusted TIER is calculated based on adjusted net income plus adjusted interest expense for the period divided by adjusted interest expense for the period.

Debt-to-Equity and Adjusted Debt-to-Equity

Management relies on the adjusted debt-to-equity ratio as a key measure in managing our business. We therefore believe that this adjusted measure, in combination with the comparable GAAP measure, is useful to investors in evaluating performance. We adjust the comparable GAAP measure to:

- exclude debt used to fund loans that are guaranteed by RUS from total liabilities;
- exclude from total liabilities, and add to total equity, debt with equity characteristics issued to our members and in the capital markets; and
- 

exclude the noncash impact of derivative financial instruments and foreign currency adjustments from total liabilities and total equity.

We are an eligible lender under a RUS loan guarantee program. Loans issued under this program carry the U.S. government's guarantee of all interest and principal payments. We have little or no risk associated with the collection of principal and interest payments on these loans. Therefore, we believe there is little or no risk related to the repayment of the liabilities used to fund RUS-guaranteed loans and we subtract such liabilities from total liabilities to calculate our adjusted debt-to-equity ratio.

Members may be required to purchase subordinated certificates as a condition of membership and as a condition to obtaining a loan or guarantee. The subordinated certificates are accounted for as debt under GAAP. The subordinated certificates have long-dated maturities and pay no interest or pay interest that is below market, and under certain conditions we are prohibited from making interest payments to members on the subordinated certificates. For computing our adjusted debt-to-equity ratio we subtract members' subordinated certificates from total liabilities and add members' subordinated certificates to total equity.

We also sell subordinated deferrable debt in the capital markets with maturities of up to 30 years and the option to defer interest payments. The characteristics of subordination, deferrable interest and long-dated maturity are all equity characteristics. For computing our adjusted debt-to-equity ratio we subtract subordinated deferrable debt from total liabilities and add it to total equity.

We record derivative instruments at fair value on our consolidated balance sheets. For computing our adjusted debt-to-equity ratio we exclude the noncash impact of our derivative accounting from liabilities and equity. Also, for computing our adjusted debt-to-equity ratio we exclude the impact of foreign currency valuation adjustments from liabilities and equity. The debt-to-equity ratio adjusted to exclude the effect of foreign currency translation reflect management's perspective on our operations and, therefore, we believe is a useful financial measure for investors.

Table 42 provides a reconciliation between the liabilities and equity used to calculate the debt-to-equity ratio and the adjusted debt-to-equity ratio as of May 31, 2018, 2017, 2016, 2015 and 2014. As indicated in the table below, subordinated debt is treated in the same manner as equity in calculating our adjusted-debt-to-equity ratio.

Table 42: Adjusted Financial Measures — Balance Sheet

| | May 31, | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2016 | 2015 | 2014 |
| Total liabilities | $25,184,351 | $24,106,887 | $23,452,822 | $21,934,273 | $21,220,311 |
| Exclude: | | | | | |
| Derivative liabilities | 275,932 | 385,337 | 594,820 | 408,382 | 388,208 |
| Debt used to fund loans guaranteed by RUS | 160,865 | 167,395 | 173,514 | 179,241 | 201,863 |
| Subordinated deferrable debt | 742,410 | 742,274 | 742,212 | 395,699 | 395,627 |
| Subordinated certificates | 1,379,982 | 1,419,025 | 1,443,810 | 1,505,420 | 1,612,191 |
| Adjusted total liabilities | $22,625,162 | $21,392,856 | $20,498,466 | $19,445,531 | $18,622,422 |
| | | | | | |
| Total equity | $1,505,853 | $1,098,805 | $817,378 | $911,786 | $970,374 |
| Exclude: | | | | | |
| Prior-year cumulative derivative forward value losses | (340,976) | (520,357) | (299,274) | (185,181) | (224,722) |
| Current-year cumulative derivative forward value (gains) losses | 306,002 | 179,381 | (221,083) | (114,093) | 39,541 |
| Accumulated other comprehensive income (1) | 1,980 | 3,702 | 4,487 | 5,371 | 6,320 |
| Include: | | | | | |
| Subordinated certificates | 1,379,982 | 1,419,025 | 1,443,810 | 1,505,420 | 1,612,191 |

| | | | | | |
|---|---|---|---|---|---|
| Subordinated deferrable debt | 742,410 | 742,274 | 742,212 | 395,699 | 395,627 |
| Adjusted total equity | $3,661,239 | $3,597,378 | $3,519,270 | $3,106,808 | $3,157,053 |

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(1) Represents AOCI related to derivatives. See “Note 10—Equity” for a breakout of our AOCI components.

Table 43 displays the calculations of our debt-to-equity and adjusted debt-to-equity ratios as of the years ended May 31, 2018, 2017, 2016, 2015 and 2014.

Table 43: Debt-to-Equity Ratio

| | May 31, | | | | |
|---|---|---|---|---|---|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| Debt-to-equity ratio (1) | 16.72 | 21.94 | 28.69 | 24.06 | 21.87 |
| Adjusted debt-to-equity ratio (2) | 6.18 | 5.95 | 5.82 | 6.26 | 5.90 |

(1) Calculated based on total liabilities as of the end of the period divided by total equity as of the end of the period.
(2) Calculated based on adjusted total liabilities at period end divided by adjusted total equity at period end.

Members' Equity

Total CFC equity includes the noncash impact of derivative forward value gains (losses) and foreign currency adjustments recorded in net income. It also includes amounts recorded in accumulated other comprehensive income. We provide the components of accumulated other comprehensive income in "Note 10—Equity." Because these amounts generally have not been realized, they are not available to members and are excluded by CFC's Board of Directors in determining the annual allocation of adjusted net income to patronage capital, members' capital reserve and other member funds. We therefore exclude from total CFC equity the cumulative impact of changes in derivative forward value gains (losses) and foreign currency adjustments and accumulated other comprehensive income because these amounts have not been realized to reflect what management considers to be equity available to members.

Table 44 provides a reconciliation of members' equity to total CFC equity as of May 31, 2018 and 2017.

Table 44: Members' Equity

| | May 31, | |
|---|---|---|
| (Dollars in thousands) | 2018 | 2017 |
| Members' equity: | | |
| Total CFC equity | $1,474,333 | $1,069,953 |
| Excludes: | | |
| Accumulated other comprehensive income | 8,544 | 13,175 |
| Current year-end cumulative derivative forward value losses | (30,831) | (332,525) |
| Subtotal | (22,287) | (319,350) |
| Members' equity | $1,496,620 | $1,389,303 |

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

For quantitative and qualitative disclosures about market risk, see “Item 7. MD&A—Market Risk” and “Note 9—Derivative Instruments and Hedging Activities.”

Item 8. Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Members
National Rural Utilities Cooperative Finance Corporation:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of National Rural Utilities Cooperative Finance Corporation and subsidiaries (the Company) as of May 31, 2018 and 2017, the related consolidated statements of operations, comprehensive income, changes in equity, and cash flows for each of the years in the three year period ended May 31, 2018, and the related notes (collectively, the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of May 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the three year period ended May 31, 2018, in conformity with U.S. generally accepted accounting principles.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ KPMG LLP

We have served as the Company's auditor since 2013.
McLean, Virginia
July 31, 2018

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

| | Year Ended May 31, | | |
|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2016 |
| Interest income | $1,077,357 | $1,036,634 | $1,012,636 |
| Interest expense | (792,735) | (741,738) | (681,850) |
| Net interest income | 284,622 | 294,896 | 330,786 |
| Benefit (provision) for loan losses | 18,575 | (5,978) | 646 |
| Net interest income after benefit (provision) for loan losses | 303,197 | 288,918 | 331,432 |
| Non-interest income: | | | |
| Fee and other income | 17,578 | 19,713 | 21,785 |
| Derivative gains (losses) | 231,721 | 94,903 | (309,841) |
| Results of operations of foreclosed assets | — | (1,749) | (6,899) |
| Total non-interest income | 249,299 | 112,867 | (294,955) |
| Non-interest expense: | | | |
| Salaries and employee benefits | (51,422) | (47,769) | (44,590) |
| Other general and administrative expenses | (39,462) | (38,457) | (41,753) |
| Gains (losses) on early extinguishment of debt | — | 192 | (333) |
| Other non-interest expense | (1,943) | (1,948) | (1,260) |
| Total non-interest expense | (92,827) | (87,982) | (87,936) |
| Income (loss) before income taxes | 459,669 | 313,803 | (51,459) |
| Income tax expense | (2,305) | (1,704) | (57) |
| Net income (loss) | 457,364 | 312,099 | (51,516) |
| Less: Net (income) loss attributable to noncontrolling interests | (2,178) | (2,193) | 1,863 |
| Net income (loss) attributable to CFC | $455,186 | $309,906 | $(49,653) |

See accompanying notes to consolidated financial statements.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| | Year Ended May 31, | | |
|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2016 |
| Net income (loss) | $457,364 | $312,099 | $(51,516) |
| Other comprehensive income (loss): | | | |
| Unrealized gains (losses) on available-for-sale investment securities | (3,222) | 4,614 | 3,468 |
| Unrealized losses on foreclosed assets | — | — | (5,575) |
| Unrealized losses on cash flow hedges | (1,059) | — | — |
| Reclassification of losses on foreclosed assets to net income | — | 9,823 | — |
| Reclassification of derivative gains to net income | (663) | (785) | (888) |
| Defined benefit plan adjustments | 313 | (1,535) | (31) |
| Other comprehensive income (loss) | (4,631) | 12,117 | (3,026) |
| Total comprehensive income (loss) | 452,733 | 324,216 | (54,542) |
| Less: Total comprehensive (income) loss attributable to noncontrolling interests | (2,178) | (2,193) | 1,867 |
| Total comprehensive income (loss) attributable to CFC | $450,555 | $322,023 | $(52,675) |

See accompanying notes to consolidated financial statements.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION
CONSOLIDATED BALANCE SHEETS

| | May 31, | |
|---|---|---|
| (Dollars in thousands) | 2018 | 2017 |
| Assets: | | |
| Cash and cash equivalents | $230,999 | $166,615 |
| Restricted cash | 7,825 | 21,806 |
| Time deposits | 101,000 | 226,000 |
| Investment securities: | | |
| Available for sale, at fair value | 89,332 | 92,554 |
| Held to maturity, at amortized cost | 519,519 | — |
| Total investment securities | 608,851 | 92,554 |
| Loans to members | 25,178,608 | 24,367,044 |
| Less: Allowance for loan losses | (18,801) | (37,376) |
| Loans to members, net | 25,159,807 | 24,329,668 |
| Accrued interest receivable | 127,442 | 111,493 |
| Other receivables | 39,220 | 45,469 |
| Fixed assets, net | 116,031 | 122,260 |
| Derivative assets | 244,526 | 49,481 |
| Other assets | 54,503 | 40,346 |
| Total assets | $26,690,204 | $25,205,692 |
| | | |
| Liabilities: | | |
| Accrued interest payable | $149,284 | $137,476 |
| Debt outstanding: | | |
| Short-term borrowings | 3,795,910 | 3,342,900 |
| Long-term debt | 18,714,960 | 17,955,594 |
| Subordinated deferrable debt | 742,410 | 742,274 |
| Members’ subordinated certificates: | | |
| Membership subordinated certificates | 630,448 | 630,098 |
| Loan and guarantee subordinated certificates | 528,386 | 567,830 |
| Member capital securities | 221,148 | 221,097 |
| Total members’ subordinated certificates | 1,379,982 | 1,419,025 |
| Total debt outstanding | 24,633,262 | 23,459,793 |
| Deferred income | 65,922 | 73,972 |
| Derivative liabilities | 275,932 | 385,337 |
| Other liabilities | 59,951 | 50,309 |
| Total liabilities | 25,184,351 | 24,106,887 |
| | | |
| Commitments and contingencies | | |
| | | |
| Equity: | | |
| CFC equity: | | |
| Retained equity | 1,465,789 | 1,056,778 |
| Accumulated other comprehensive income | 8,544 | 13,175 |
| Total CFC equity | 1,474,333 | 1,069,953 |
| Noncontrolling interests | 31,520 | 28,852 |

| | | |
|---|---|---|
| Total equity | 1,505,853 | 1,098,805 |
| Total liabilities and equity | $26,690,204 | $25,205,692 |

See accompanying notes to consolidated financial statements.

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NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

| (Dollars in thousands) | Membership Fees and Educational Fund | Patronage Capital Allocated | Members' Capital Reserve | Unallocated Net Income (Loss) | CFC Retained Equity | Accumulated Other Comprehensive Income | Total CFC Equity | Non-controlling Interests | Total Equity |
|---|---|---|---|---|---|---|---|---|---|
| Balance as of May 31, 2015 | $2,743 | $668,980 | $501,731 | $(293,212) | $880,242 | $4,080 | $884,322 | $27,464 | $911,786 |
| Net income (loss) | 1,000 | 84,257 | 85,917 | (220,827) | (49,653) | — | (49,653) | (1,863) | (51,516) |
| Other comprehensive loss | — | — | — | — | — | (3,022) | (3,022) | (4) | (3,026) |
| Patronage capital retirement | — | (39,384) | — | — | (39,384) | — | (39,384) | — | (39,384) |
| Other | (971) | — | (429) | 429 | (971) | — | (971) | 489 | (482) |
| Balance as of May 31, 2016 | $2,772 | $713,853 | $587,219 | $(513,610) | $790,234 | $1,058 | $791,292 | $26,086 | $817,378 |
| Net income | 1,000 | 90,441 | 43,086 | 175,379 | 309,906 | — | 309,906 | 2,193 | 312,099 |
| Other comprehensive income | — | — | — | — | — | 12,117 | 12,117 | — | 12,117 |
| Patronage capital retirement | — | (42,593) | — | 103 | (42,490) | — | (42,490) | — | (42,490) |
| Other | (872) | — | — | — | (872) | — | (872) | 573 | (299) |
| Balance as of May 31, 2017 | $2,900 | $761,701 | $630,305 | $(338,128) | $1,056,778 | $13,175 | $1,069,953 | $28,852 | $1,098,805 |
| Net income | 1,000 | 95,012 | 57,480 | 301,694 | 455,186 | — | 455,186 | 2,178 | 457,364 |
| Other comprehensive loss | — | — | — | — | — | (4,631) | (4,631) | — | (4,631) |
| Patronage capital retirement | — | (45,220) | — | — | (45,220) | — | (45,220) | — | (45,220) |
| Other | (955) | — | — | — | (955) | — | (955) | 490 | (465) |
| Balance as of May 31, 2018 | $2,945 | $811,493 | $687,785 | $(36,434) | $1,465,789 | $8,544 | $1,474,333 | $31,520 | $1,505,853 |

See accompanying notes to consolidated financial statements.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Year Ended May 31, | | |
|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2016 |
| Cash flows from operating activities: | | | |
| Net income (loss) | $457,364 | $312,099 | $(51,516) |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Amortization of deferred loan fees | (11,296) | (14,072) | (18,751) |
| Amortization of debt issuance costs and deferred charges | 10,456 | 9,484 | 8,478 |
| Amortization of discount on long-term debt | 10,164 | 9,501 | 8,693 |
| Amortization of issuance costs for bank revolving lines of credit | 5,346 | 5,531 | 5,535 |
| Depreciation and amortization | 7,931 | 7,173 | 7,327 |
| Provision (benefit) for loan losses | (18,575) | 5,978 | (646) |
| Results of operations of foreclosed assets | — | 1,749 | 6,899 |
| Derivative forward value (gains) losses | (306,002) | (179,381) | 221,083 |
| Changes in operating assets and liabilities: | | | |
| Accrued interest receivable | (15,949) | 1,778 | (6,225) |
| Accrued interest payable | 11,808 | 4,480 | 9,299 |
| Deferred income | 3,246 | 9,393 | 21,822 |
| Other | 741 | 5,855 | 15,560 |
| Net cash provided by operating activities | 155,234 | 179,568 | 227,558 |
| Cash flows from investing activities: | | | |
| Advances on loans, net | (811,164) | (1,145,673) | (1,693,084) |
| Investment in fixed assets | (15,194) | (17,793) | (9,806) |
| Net cash proceeds from sale of foreclosed assets | — | 51,042 | 5,414 |
| Proceeds from foreclosed assets | — | — | (4,349) |
| Net proceeds from time deposits | 125,000 | 114,000 | 145,000 |
| Purchases of held-to-maturity investments | (510,598) | — | — |
| Proceeds from maturities of held-to-maturity investments | 1,394 | — | — |
| Change in restricted cash | 13,981 | (17,178) | (4,143) |
| Net cash used in investing activities | (1,196,581) | (1,015,602) | (1,560,968) |
| Cash flows from financing activities: | | | |
| Proceeds from (repayments of) short-term borrowings, net | 126,211 | 409,871 | (154,072) |
| Proceeds from short-term borrowings with original maturity greater than 90 days | 1,331,910 | 1,003,185 | 890,242 |
| Repayments of short term-debt with original maturity greater than 90 days | (1,005,111) | (1,009,004) | (925,076) |
| Payments for issuance costs for revolving bank lines of credit | (2,441) | (2,548) | (3,009) |
| Proceeds from issuance of long-term debt, net of discount and issuance costs | 2,349,885 | 2,923,868 | 2,920,669 |
| Payments for retirement of long-term debt | (1,611,002) | (2,460,730) | (1,709,283) |
| Payments for issuance costs for subordinated deferrable debt | — | (68) | — |
| Proceeds from issuance of subordinated debt | — | — | 346,433 |
| Proceeds from issuance of members' subordinated certificates | 6,136 | 3,626 | 5,654 |
| Payments for retirement of members' subordinated certificates | (45,180) | (28,220) | (43,596) |
| Payments for retirement of patronage capital | (44,667) | (41,871) | (38,848) |
| Repayments for membership fees, net | (10) | — | — |
| Net cash provided by financing activities | 1,105,731 | 798,109 | 1,289,114 |
| Net increase (decrease) in cash and cash equivalents | 64,384 | (37,925) | (44,296) |
| Beginning cash and cash equivalents | 166,615 | 204,540 | 248,836 |
| Ending cash and cash equivalents | $230,999 | $166,615 | $204,540 |

See accompanying notes to consolidated financial statements.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Year Ended May 31, | | |
|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2016 |
| Supplemental disclosure of cash flow information: | | | |
| Cash paid for interest | $766,059 | $712,742 | $649,845 |
| Cash paid for income taxes | 321 | 407 | 72 |
| | | | |
| Noncash financing and investing activities: | | | |
| Loan provided in connection with the sale of foreclosed assets | $— | $60,000 | $— |

See accompanying notes to consolidated financial statements.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 1—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### The Company

National Rural Utilities Cooperative Finance Corporation ("CFC") is a member-owned cooperative association incorporated under the laws of the District of Columbia in April 1969. CFC's principal purpose is to provide its members with financing to supplement the loan programs of the Rural Utilities Service ("RUS") of the United States Department of Agriculture ("USDA"). CFC makes loans to its rural electric members so they can acquire, construct and operate electric distribution, generation and transmission ("power supply") systems and related facilities. CFC also provides its members with credit enhancements in the form of letters of credit and guarantees of debt obligations. As a cooperative, CFC is owned by and exclusively serves its membership, which consists of not-for-profit entities or subsidiaries or affiliates of not-for-profit entities. CFC is exempt from federal income taxes.

National Cooperative Services Corporation ("NCSC") is a taxable cooperative incorporated in 1981 in the District of Columbia as a member-owned cooperative association. NCSC's principal purpose is to provide financing to members of CFC, entities eligible to be members of CFC and the for-profit and nonprofit entities that are owned, operated or controlled by or provide significant benefit to certain members of CFC. NCSC's membership consists of distribution systems, power supply systems and statewide and regional associations that are members of CFC. CFC is the primary source of funding for NCSC and manages NCSC's business operations under a management agreement that is automatically renewable on an annual basis unless terminated by either party. NCSC pays CFC a fee and, in exchange, CFC reimburses NCSC for loan losses under a guarantee agreement. As a taxable cooperative, NCSC pays income tax based on its reported taxable income and deductions. NCSC is headquartered with CFC in Dulles, Virginia.

Rural Telephone Finance Cooperative ("RTFC") is a taxable Subchapter T cooperative association originally incorporated in South Dakota in 1987 and reincorporated as a member-owned cooperative association in the District of Columbia in 2005. RTFC's principal purpose is to provide financing for its rural telecommunications members and their affiliates. RTFC's membership consists of a combination of not-for-profit and for-profit entities. CFC is the sole lender to and manages the business operations of RTFC through a management agreement that is automatically renewable on an annual basis unless terminated by either party. RTFC pays CFC a fee and, in exchange, CFC reimburses RTFC for loan losses under a guarantee agreement. As permitted under Subchapter T of the Internal Revenue Code, RTFC pays income tax based on its net income, excluding patronage-sourced earnings allocated to its patrons. RTFC is headquartered with CFC in Dulles, Virginia.

### Basis of Presentation and Use of Estimates

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts and related disclosures. The most significant estimates and assumptions involve determining the allowance for loan losses and the fair value of financial assets and liabilities. While management makes its best judgment, actual amounts or results could differ from these estimates. Certain reclassifications have been made to previously reported amounts to conform to the current-period presentation.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of CFC, variable interest entities (“VIEs”) where CFC is the primary beneficiary and subsidiary entities created and controlled by CFC to hold foreclosed assets. CFC did not have any entities that held foreclosed assets as of May 31, 2018 or May 31, 2017. All intercompany balances and transactions have been eliminated. NCSC and RTFC are VIEs that are required to be consolidated by CFC. Unless stated otherwise, references to “we, “our” or “us” relate to CFC and its consolidated entities.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Variable Interest Entities

A VIE is an entity that has a total equity investment at risk that is not sufficient to finance its activities without additional subordinated financial support provided by another party, or where the group of equity holders does not have: (i) the ability to make decisions about the entity's activities that most significantly impact its economic performance; (ii) the obligation to absorb the entity's expected losses; or (iii) the right to receive the entity's expected residual returns.

NCSC and RTFC meet the definition of variable interest entities because they do not have sufficient equity investment at risk to finance their activities without additional financial support. When evaluating an entity for possible consolidation, we must determine whether or not we have a variable interest in the entity. If it is determined that we do not have a variable interest in the entity, no further analysis is required and we do not consolidate the entity. If we have a variable interest in the entity, we must evaluate whether we are the primary beneficiary based on an assessment of quantitative and qualitative factors. We are considered the primary beneficiary holder if we have a controlling financial interest in the VIE that provides (i) the power to direct the activities of the VIE that most significantly impact the VIE's economic performance and (ii) the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. We consolidate the results of NCSC and RTFC with CFC because CFC is the primary beneficiary holder.

Cash and Cash Equivalents

Cash, certificates of deposit, due from banks and other investments with original maturities of less than 90 days are classified as cash and cash equivalents.

Restricted Cash

Restricted cash totaled $8 million and $22 million as of May 31, 2018 and 2017, respectively. On July 1, 2016, CFC completed the sale of Caribbean Asset Holdings, LLC ("CAH"), an entity that held foreclosed assets, to ATN VI Holdings, LLC. In connection with the sale, $16 million of the sale proceeds was deposited into escrow to fund potential indemnification claims following the closing. Of this amount, $14.5 million was designated to cover general indemnification claims and has been released back to us. The remaining $1.5 million was designated to cover indemnification of certain tax liens and remains in escrow. We continue to be liable for certain indemnification obligations, if raised and substantiated, regardless of whether amounts are held in escrow.

Time Deposits

Time deposits are deposits that we make with financial institutions in interest-bearing accounts. These deposits have a maturity of less than one year as of the reporting date and are valued at carrying value, which approximates fair value.

Investment Securities

We record purchases and sales of securities on a trade-date basis. We currently classify and account for our investment securities as either available for sale ("AFS") or held to maturity ("HTM") based on our investment strategy and management's assessment of our intent and ability to hold the securities until maturity. Securities that we may sell prior to maturity in response to changes in our investment strategy, liquidity needs, credit risk mitigating considerations, market risk profile or for other reasons are classified as AFS. Securities that we have the positive intent and ability to hold until maturity are classified as HTM.

Our investment securities classified as AFS consist of investments in Federal Agricultural Mortgage Corporation ("Farmer Mac") Series A common stock and Farmer Mac Series A, Series B and Series C non-cumulative preferred stock. AFS securities are carried at fair value on our consolidated balance sheets with unrealized gains and losses recorded as a component of accumulated other comprehensive income.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Our investment securities classified as HTM consist of investments in certificates of deposit with maturities greater than 90 days, commercial paper, corporate debt securities, commercial mortgage-backed securities (“MBS”) and other asset-backed securities (“ABS”). We have the positive intent and ability to hold these securities to maturity. As such, we have classified them as HTM on our consolidated balance sheet. HTM securities are carried at amortized cost on our consolidated balance sheets. Interest income on fixed-income securities, including amortization of premiums and accretion of discounts, is generally recognized over the contractual life of the securities based on the effective yield method.

We regularly evaluate our investment securities whose fair value has declined below the amortized cost to assess whether the decline in fair value is other than temporary. We recognize any other-than-temporary impairment amounts in earnings.

Loans to Members

Loans to members are classified as held for investment and reported at amortized cost, which is measured based on the outstanding principal balance net of unamortized deferred loan origination costs. Deferred loan origination costs are amortized using the straight-line method, which approximates the effective interest method, into interest income over the life of the loan.

Nonperforming Loans

A loan is considered past due if a full payment of interest and principal is not received within 30 days of its due date. Loans are classified as nonperforming when the collection of interest and principal has become 90 days past due; court proceedings indicate that collection of interest and principal in accordance with the contractual terms is unlikely; or the full and timely collection of interest or principal becomes otherwise.

Once a loan is classified as nonperforming, we typically place the loan on nonaccrual status and reverse any accrued and unpaid interest recorded during the period in which the loan is classified as nonperforming. We generally apply all cash received during the nonaccrual period to the reduction of principal, thereby foregoing interest income recognition. The decision to return a loan to accrual status is determined on a case-by-case basis.

We fully charge off or write down loans to the estimated net realizable value in the period that it becomes evident that collectability of the full contractual amount is highly unlikely; however, our efforts to recover all charged-off amounts may continue. The determination to write off all or a portion of a loan balance is made based on various factors on a case-by-case basis including, but not limited to, cash flow analysis and the fair value of collateral securing the borrower’s loans.

Impaired Loans

A loan is considered impaired when, based on current information and events, we determine that it is probable that we will be unable to collect all interest and principal amounts due as scheduled in accordance with the contractual terms of the loan agreement, other than an insignificant delay in payment or insignificant shortfall in payment amount. Factors considered in determining impairment may include, but are not limited to:

- the review of the borrower's audited financial statements and interim financial statements if available,
- the borrower's payment history,
- communication with the borrower,
- economic conditions in the borrower's service territory,
- pending legal action involving the borrower,
- restructure agreements between us and the borrower, and
- estimates of the value of the borrower's assets that have been pledged as collateral to secure our loans.

We recognize interest income on impaired loans on a case-by-case basis. An impaired loan to a borrower that is nonperforming will typically be placed on nonaccrual status and we will reverse all accrued and unpaid interest. We

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

generally apply all cash received during the nonaccrual period to the reduction of principal, thereby foregoing interest income recognition. Interest income may be recognized on an accrual basis for restructured impaired loans where the borrower is performing and is expected to continue to perform based on agreed-upon terms.

We may modify the terms of a loan to maximize the collection of amounts due when a borrower is experiencing financial difficulties. Concessionary modifications are classified as troubled debt restructurings ("TDRs") unless the modification results in only an insignificant delay in payments to be received. All of our restructured loans are considered TDRs.

Allowance for Loan Losses

We maintain an allowance for loan losses that represents management's estimate of probable losses inherent in our loan portfolio as of each balance sheet date. Our allowance for loan losses consists of a collective allowance for loans in our portfolio that are not individually impaired and a specific allowance for loans identified as individually impaired.
The allowance for loan losses is reported separately on the consolidated balance sheet, and the provision for loan losses is separately reported on our consolidated statement of operations.

We review the estimates and assumptions used in the calculations of the allowance for loan losses on a quarterly basis. The estimate of the allowance for loan losses is based on a review of the composition of the loan portfolio, past loss experience, specific problem loans, current economic conditions, available market data and/or projection of future cash flows and other pertinent factors that in management's judgment may contribute to incurred losses. The allowance is based on estimates and, accordingly, actual losses may differ from the allowance amount. The methodology used to calculate the allowance for loan losses is summarized below.

Collective Allowance

The collective loss reserve is calculated using an internal model to estimate incurred losses for segments within our loan portfolio that have similar risk characteristics. The segments reflect each of our consolidated entities: CFC, NCSC and RTFC. Our segments are further stratified into loan pools based on member borrower type—distribution, power supply, and statewide and associates—and borrower risk ratings. We then apply loss factors to the outstanding principal balance of each of these loan pools to determine the collective allowance for loan losses. The loss factors reflect the probability of default, or default rate, and the loss severity, or loss given default, for each loan pool. We derive the total quantitative loss estimate by applying the default rate, based on a five-year loss emergence period, and recovery rate, based on our historical experience, to each loan pool. Following is additional information on the key inputs and assumptions used in determining our collective allowance for loan losses.

Internal risk ratings. As part of our credit risk management process, we regularly evaluate each borrower and loan facility in our loan portfolio and assign an internal risk rating. Our borrower risk rating is intended to reflect probability of default. The risk ratings are based on the following quantitative and qualitative factors:

general financial condition of the borrower;
our judgment of the quality of the borrower’s management;
our judgment of the borrower’s competitive position within its service territory and industry;
our estimate of the potential impact of proposed regulation and litigation; and
other factors specific to individual borrowers or classes of borrowers.

- Loss emergence period: The loss emergence period, or the time it takes from when a loss-triggering event happens in the loan portfolio until it is identified and a problem loan is charged off, repaid or otherwise resolved, is based on CFC’s historical average loss emergence experience.
- Default rates: Because we have limited default history from which to develop default estimates, we utilize third-party industry default data to estimate default rates. We currently obtain this information from the U.S. utility default rate table published annually by S&P Global Inc. (“S&P”). This table provides historical expected default rates for the utility sector based on credit rating levels and remaining maturity. We correlate our internal risk ratings to the S&P credit

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NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

ratings provided in the utility default rate table and apply the S&P default rates for our estimated loss emergence period to our loan pools.

- Recovery rates. To estimate our loss severity in the event of default, we utilize our historical charge-off experience for each borrower type, which is subject to adjustment based on management's quantitative and qualitative assessment of current conditions.

Specific Allowance

We generally measure impairment for individually impaired loans based on the difference between the recorded investment of the loan and the present value of the expected future cash flows discounted at the loan's effective interest rate. If the loan is collateral dependent, we measure impairment based upon the fair value of the underlying collateral, which we determine based on the current fair value of the collateral less estimated selling costs. Loans are considered to be collateral dependent if repayment of the loan is expected to be provided solely by the underlying collateral and there are no other available and reliable sources of repayment.

In calculating the impairment on a loan, the estimates of the expected future cash flows or collateral value are the key estimates made by management. Changes in the estimated future cash flows or collateral value affect the amount of the calculated impairment. The change in cash flows required to make the change in the calculated impairment material will be different for each borrower and depend on the period covered, the effective interest rate at the time the loan became impaired and the amount of the loan outstanding. Estimates are not used to determine our investment in the receivables or the discount rate since, in all cases, the investment is equal to the loan balance outstanding at the reporting date, and the discount rate is equal to the effective interest rate on the loan at the time the loan became impaired.

Unadvanced Loan Commitments

Unadvanced commitments represent amounts for which we have approved and executed loan contracts, but the funds have not been advanced. The majority of the unadvanced commitments reported represent amounts that are subject to material adverse change clauses at the time of the loan advance. Prior to making an advance on these facilities, we would confirm that there has been no material adverse change in the business or condition, financial or otherwise, of the borrower since the time the loan was approved and confirm that the borrower is currently in compliance with loan terms and conditions. The remaining unadvanced commitments relate to line of credit loans that are not subject to a material adverse change clause at the time of each loan advance. As such, we would be required to advance amounts on these committed facilities as long as the borrower is in compliance with the terms and conditions of the loan commitment.

Unadvanced loan commitments related to line of credit loans are typically for periods not to exceed five years and are generally revolving facilities used for working capital and backup liquidity purposes. Historically, we have experienced a very low utilization rate on line of credit loan facilities, whether or not there is a material adverse change clause. Since we generally do not charge a fee on the unadvanced portion of the majority of our loan facilities,

our borrowers will typically request long-term facilities to fund construction work plans and other capital expenditures for periods of up to five years and draw down on the facility over that time. In addition, borrowers will typically request an amount in excess of their immediate estimated loan requirements to avoid the expense related to seeking additional loan funding for unexpected items. These factors contribute to our expectation that the majority of the unadvanced loan commitments will expire without being fully drawn upon and that the total unadvanced amount does not necessarily represent future cash funding
requirements.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Reserve for Unadvanced Loan Commitments

We maintain a reserve for unadvanced loan commitments and committed lines of credit. This reserve is included as a component of other liabilities on our consolidated balance sheets, and changes in the reserve are included in other non-interest expense on our consolidated statements of operations. Our estimate of the reserve for potential losses on these commitments takes into consideration various factors, including the existence of a material adverse change clause, the historical utilization of the committed lines of credit, the probability of funding, historical loss experience on unadvanced loan commitments and other inputs along with management judgment consistent with the methodology used to determine our allowance for loan losses.

Fixed Assets

Fixed assets are recorded at cost less accumulated depreciation. We recognize depreciation expense for each category of our depreciable fixed assets on a straight-line basis over the estimated useful life, which ranges from three to 40 years. We recognized depreciation expense of $8 million, $7 million and $7 million in fiscal year 2018, 2017 and 2016, respectively. The table below displays the components of our fixed assets. Our headquarters facility in Loudoun County, Virginia, which is owned by CFC, is included as a component of building and building equipment.

| | May 31, | |
|---|---|---|
| (Dollars in thousands) | 2018 | 2017 |
| Building and building equipment | $50,210 | $50,236 |
| Furniture and fixtures | 6,080 | 5,852 |
| Computer software and hardware | 45,389 | 40,469 |
| Other | 1,006 | 1,034 |
| Depreciable fixed assets | 102,685 | 97,591 |
| Less: Accumulated depreciation | (47,705) | (41,274) |
| Net depreciable fixed assets | 54,980 | 56,317 |
| Land | 23,796 | 37,847 |
| Software development | 37,255 | 28,096 |
| Fixed assets, net | $116,031 | $122,260 |

Assets Held for Sale

An asset is classified as held for sale when (i) management commits to a plan to sell the asset or business; (ii) the asset or business is available for sale in its present condition; (iii) the asset or business is actively marketed for sale at a reasonable price; (iv) the sale is expected to be completed within one year; and (v) it is unlikely significant changes to the plan will be made or that the plan will be withdrawn. Long-lived assets classified as held for sale are initially measured at the lower of their carrying amount or fair value less cost to sell. If the carrying value exceeds the estimated fair value less cost to sell in the period the held for sale criteria are met, an impairment charge is recorded equal to the amount by which the carrying amount exceeds the fair value less cost to sell. Subsequent changes in the long-lived asset's fair value less cost to sell is reported as an adjustment to the carrying amount to the extent that the adjusted carrying amount does not exceed the carrying amount of the long-lived asset at the time it was initially classified as held for sale.

In 2007, CFC purchased a parcel of land, consisting of approximately 28 acres, located in Loudoun County, Virginia as a potential site to construct a new facility for our headquarters. We subsequently identified another site in Loudoun County for our headquarters, purchased the land and built our headquarters facility at that location. On March 14, 2018, CFC entered into a purchase and sale agreement ("the agreement"), subsequently amended on April 23, 2018, for the sale of this real estate property in excess of its carrying value of $14 million, subject to certain terms and conditions. Although we currently believe the disposition of this property is probable within the next 12 months, there can be no assurance that the disposition will be consummated in accordance with the terms of the agreement.

The property was previously included in fixed assets, net on our consolidated balance sheet. In the third quarter of fiscal year 2018, we designated the property as held for sale fiscal year 2018 and reclassified it from fixed assets, net to other assets on our consolidated balance sheet. Based on the estimated sale proceeds less cost to sell, we expect to record a gain on the sale of this property.

Foreclosed Assets

Foreclosed assets acquired through our lending activities in satisfaction of indebtedness may be held in operating entities created and controlled by CFC and presented separately in our consolidated balance sheets under foreclosed assets, net. These assets are initially recorded at estimated fair value as of the date of acquisition. Subsequent to acquisition, foreclosed assets not classified as held for sale are evaluated for impairment, and the results of operations and any impairment are reported on our consolidated statements of operations under results of operations of foreclosed assets. When foreclosed assets meet the accounting criteria to be classified as held for sale, they are recorded at the lower of cost or fair value less estimated cost to sell at the date of transfer, with the amount at the date of transfer representing the new cost basis. Subsequent changes are recognized in our consolidated statements of operations under results of operations of foreclosed assets. We also review foreclosed assets classified as held for sale each reporting period to determine whether the existing carrying amounts are fully recoverable in comparison to estimated fair values. We did not carry any foreclosed assets on our consolidated balance sheet as of May 31, 2018 or May 31, 2017.

Debt

We report debt at cost net of unamortized issuance costs and discounts or premiums. Issuance costs, discounts and premiums are deferred and amortized into interest expense using the effective interest method or a method approximating the effective interest method over the legal maturity of each bond issue. Short-term borrowings consist of borrowings with an original contractual maturity of one year or less and do not include the current portion of long-term debt. Borrowings with an original contractual maturity of greater than one year are classified as long-term debt.

Derivative Instruments

We are an end user of derivative financial instruments and do not engage in derivative trading. We use derivatives, primarily interest rate swaps and treasury rate locks, to manage interest rate risk. Derivatives may be privately negotiated contracts, which are often referred to as over-the-counter ("OTC") derivatives, or they may be listed and traded on an exchange. We generally engage in OTC derivative transactions.

In accordance with the accounting standards for derivatives and hedging activities, we record derivative instruments at fair value as either a derivative asset or derivative liability on our consolidated balance sheets. We report derivative asset and liability amounts on a gross basis based on individual contracts, which does not take into consideration the effects of master netting agreements or collateral netting. Derivatives in a gain position are reported as derivative assets on our consolidated balance sheets, while derivatives in a loss position are reported as derivative liabilities. Accrued interest related to derivatives is reported on our consolidated balance sheets as a component of either accrued interest receivable or accrued interest payable.

If we do not elect hedge accounting treatment, changes in the fair value of derivative instruments, which consist of net accrued periodic derivative cash settlements and derivative forward value amounts, are recognized in our consolidated statements of operations under derivative gains (losses). If we elect hedge accounting treatment for derivatives, we formally document, designate and assess the effectiveness of the hedge relationship. Changes in the fair value of derivatives designated as qualifying fair value hedges are recorded in earnings together with offsetting changes in the fair value of the hedged item and any related ineffectiveness. Changes in the fair value of derivatives designated as qualifying cash flow

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

hedges are recorded as a component of other comprehensive income (“OCI”), to the extent that the hedge relationships are effective, and reclassified from accumulated other comprehensive income (“AOCI”) to earnings using the effective interest method over the term of the forecasted transaction. Any ineffectiveness in the hedging relationship is recognized as a component of derivative gains (losses) in our consolidated statement of operations.

We generally do not designate interest rate swaps, which represent the substantial majority of our derivatives, for hedge accounting. Accordingly, changes in the fair value of interest rate swaps are reported in our consolidated statements of operations under derivative gains (losses). Net periodic cash settlements related to interest rate swaps are classified as an operating activity in our consolidated statements of cash flows.

We typically designate treasury rate locks as cash flow hedges of forecasted debt issuances or repricings. Changes in the fair value of treasury locks designated as cash flow hedges are recorded as a component of OCI and reclassified from AOCI into interest expense when the forecasted transaction occurs using the effective interest method. Any ineffectiveness is recognized as a component of derivative gains (losses) in our consolidated statements of operations.

At June 1, 2001, as a result of the adoption of the derivative accounting guidance that required derivatives to be reported at fair value on the balance sheet, we recorded a transition adjustment net loss in AOCI. The transition adjustment net loss is being reclassified into earnings and reported as a component of derivative gains (losses) in our consolidated statements of operations. We expect to continue to reclassify the remaining balance of the transition adjustment to earnings through 2029.

Guarantee Liability

We maintain a guarantee liability that represents our contingent and noncontingent exposure related to guarantees and standby liquidity obligations associated with our members’ debt. The guarantee liability is included in the other liabilities line item on the consolidated balance sheet, and the provision for guarantee liability is reported in non-interest expense as a separate line item on the consolidated statement of operations.

The contingent portion of the guarantee liability represents management’s estimate of our exposure to losses within the guarantee portfolio. The methodology used to estimate the contingent guarantee liability is consistent with the methodology used to determine the allowance for loan losses.

We have recorded a noncontingent guarantee liability for all new or modified guarantees since January 1, 2003. Our noncontingent guarantee liability represents our obligation to stand ready to perform over the term of our guarantees and liquidity obligations that we have entered into or modified since January 1, 2003. Our noncontingent obligation is estimated based on guarantee and liquidity fees charged for guarantees issued, which represents management’s estimate of the fair value of our obligation to stand ready to perform. The fees are deferred and amortized using the straight-line method into interest income over the term of the guarantee.

Fair Value Valuation Processes

We present certain financial instruments at fair value, including available-for-sale investment securities and derivatives. Fair value is defined as the price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date (also referred to as an exit price). We have various processes and controls in place to ensure that fair value is reasonably estimated. We consider observable prices in the principal market in our valuations where possible. Fair value estimates were developed at the reporting date and may not necessarily be indicative of amounts that could ultimately be realized in a market transaction at a future date. With the exception of redeeming debt under early redemption provisions, terminating derivative instruments under early-termination provisions and allowing borrowers to prepay their loans, we held and intend to hold all financial instruments to maturity excluding common stock and preferred stock investments that have no stated maturity.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION
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Fair Value Hierarchy

The fair value accounting guidance provides a three-level fair value hierarchy for classifying financial instruments. This hierarchy is based on the markets in which the assets or liabilities trade and whether the inputs to the valuation techniques used to measure fair value are observable or unobservable. Fair value measurement of a financial asset or liability is assigned a level based on the lowest level of any input that is significant to the fair value measurement in its entirety. The three levels of the fair value hierarchy are summarized below:

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2: Observable market-based inputs, other than quoted prices in active markets for identical assets or liabilities
- Level 3: Unobservable inputs

The degree of management judgment involved in determining the fair value of a financial instrument is dependent upon the availability of quoted prices in active markets or observable market parameters. When quoted prices and observable data in active markets are not fully available, management's judgment is necessary to estimate fair value. Changes in market conditions, such as reduced liquidity in the capital markets or changes in secondary market activities, may reduce the availability and reliability of quoted prices or observable data used to determine fair value.

Membership Fees

Members are charged a one-time membership fee based on member class. CFC distribution system members, power supply system members and national associations of cooperatives pay a $1,000 membership fee. CFC service organization members pay a $200 membership fee and CFC associates pay a $1,000 fee. RTFC voting members pay a $1,000 membership fee and RTFC associates pay a $100 fee. NCSC members pay a $100 membership fee. Membership fees are accounted for as members' equity.

Financial Instruments with Off-Balance Sheet Risk

In the normal course of business, we are a party to financial instruments with off-balance sheet risk to meet the financing needs of our member borrowers. These financial instruments include committed lines of credit, standby letters of credit and guarantees of members' obligations.

Interest Income

Interest income on loans and investments is recognized using the effective interest method. The following table presents interest income, categorized by loan and investment type, for fiscal years 2018, 2017 and 2016.

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

| | Year Ended May 31, | | |
|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2016 |
| Interest income by interest-earning asset type: | | | |
| Long-term fixed-rate loans[1] | $1,000,492 | $980,173 | $959,701 |
| Long-term variable-rate loans | 27,152 | 19,902 | 19,858 |
| Line of credit loans | 38,195 | 25,389 | 24,864 |
| TDR loans[2] | 889 | 905 | 512 |
| Nonperforming loans | — | — | 142 |
| Other income, net[3] | (1,185) | (1,082) | (1,088) |
| Total loans | 1,065,543 | 1,025,287 | 1,003,989 |
| Cash, time deposits and investment securities | 11,814 | 11,347 | 8,647 |
| Total interest income | $1,077,357 | $1,036,634 | $1,012,636 |

[1] Includes loan conversion fees, which are generally deferred and recognized as interest income using the effective interest method.
[2] Troubled debt restructured ("TDR") loans.
(3) Consists of late payment fees and net amortization of deferred loan fees and loan origination costs.

Deferred income of $66 million and $74 million as of May 31, 2018 and 2017, respectively, consists primarily of deferred loan conversion fees totaling $60 million and $68 million, respectively. These fees are presented as deferred income on our consolidated balance sheets and recognized in interest income using the effective interest method.

Interest Expense

The following table presents interest expense, by debt product type, for fiscal years 2018, 2017 and 2016.

| | Year Ended May 31, | | |
|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2016 |
| Interest expense by debt product type:[1][2] | | | |
| Short-term borrowings | $50,616 | $26,684 | $14,728 |
| Medium-term notes | 111,814 | 99,022 | 86,270 |
| Collateral trust bonds | 336,079 | 340,854 | 333,338 |
| Guaranteed Underwriter Program notes payable | 140,551 | 142,661 | 143,240 |
| Farmer Mac notes payable | 56,004 | 33,488 | 20,529 |
| Other notes payable | 1,509 | 1,780 | 2,051 |
| Subordinated deferrable debt | 37,661 | 37,657 | 21,245 |
| Subordinated certificates | 58,501 | 59,592 | 60,449 |
| Total interest expense | $792,735 | $741,738 | $681,850 |

[1] Includes amortization of debt discounts and debt issuance costs, which are generally deferred and recognized as interest expense using the effective interest method. Issuance costs related to dealer commercial paper, however, are recognized as interest expense immediately as incurred.
[2] Includes fees related to funding arrangements, such as up-front fees paid to banks participating in our committed bank revolving line of credit agreements. Depending on the nature of the fee, amounts may be deferred and recognized as interest expense ratably over the term of the arrangement or recognized immediately as incurred.

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Early Extinguishment of Debt

We redeem outstanding debt early from time to time to manage liquidity and interest rate risk. When we redeem outstanding debt early, we recognize a gain or loss related to the difference between the amount paid to redeem the debt and the net book value of the extinguished debt as a component of non-interest expense in the gain (loss) on early extinguishment of debt line item.

Income Taxes

While CFC is exempt under Section 501(c)(4) of the Internal Revenue Code, it is subject to tax on unrelated business taxable income. NCSC is a taxable cooperative that pays income tax on the full amount of its reportable taxable income and allowable deductions. RTFC is a taxable cooperative under Subchapter T of the Internal Revenue Code and is not subject to income taxes on income from patronage sources that is allocated to its borrowers, as long as the allocation is properly noticed and at least 20% of the amount allocated is retired in cash prior to filing the applicable tax return.

On December 22, 2017, the president of the United States signed and enacted into law H.R. 1, the Tax Cuts and Jobs Act (“The Act”), which, except for certain provisions, is effective for tax years beginning on or after January 1, 2018. The Act significantly changed existing U.S. tax law and included numerous provisions that affect businesses. One of the primary changes is a reduction in the federal statutory corporate U.S. income tax rate to 21% percent from 35% and other changes that impact business-related exclusions, deductions and credits. CFC is exempt from federal income tax under Section 501(c)(4) of the Internal Revenue Code. NCSC and RTFC are subject to federal income tax; however, their annual taxable income and federal income tax is not material to our consolidated results of operations, financial condition or liquidity. RTFC’s deduction of the allocation of patronage capital to its members historically has resulted in a significant reduction in its annual taxable income and federal income tax.

The income tax benefit (expense) recorded in the consolidated statement of operations represents the income tax benefit (expense) at the applicable combined federal and state income tax rates resulting in a statutory tax rate. The statutory tax rate for NCSC and RTFC was 34% and 35%, respectively, for fiscal year 2018. The statutory tax rate for NCSC and RTFC was 38% and 40%, respectively, for fiscal year 2017 and the statutory tax rate for both NCSC and RTFC was 38% for fiscal year 2016. Substantially all of the income tax expense recorded in our consolidated statements of operations relates to NCSC. NCSC had a deferred tax asset of $2 million and $4 million as of May 31, 2018 and 2017, respectively, primarily arising from differences in the accounting and tax treatment for derivatives. We believe that it is more likely than not that the deferred tax assets will be realized through taxable earnings.

Recent Accounting Changes and Other Developments

Derivatives and Hedging—Targeted Improvements to Accounting for Hedging Activities

In August 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2017-12, Derivatives and Hedging—Targeted Improvements to Accounting for Hedging Activities, which expands the types of risk-management strategies that qualify for hedge accounting treatment to more closely align the results of hedge accounting with the economics of certain risk-management activities and simplifies certain hedge documentation and assessment requirement. It also eliminates the concept of separately recording hedge ineffectiveness and expands disclosure requirements. The guidance is effective for public entities for fiscal years beginning after December 15, 2018, including interim periods within those years. Early adoption is permitted in any interim period or fiscal year before the effective date. The guidance is effective for us beginning June 1, 2019. Hedge accounting is elective, and we currently apply hedge accounting on a limited basis, specifically when we enter into treasury rate lock agreements. If we continue to elect not to apply hedge accounting to our interest rate swaps, the adoption of the new guidance will not have a material impact on our consolidated financial statements.

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Receivables—Nonrefundable Fees and Other Cost

In March 2017, FASB issued ASU 2017-08, Receivables—Nonrefundable Fees and Other Costs, which shortens the amortization period for the premium on certain callable debt securities to the earliest call date rather the maturity date. The guidance is applicable to any individual debt security, purchased at a premium, with an explicit and noncontingent call feature with a fixed price on a preset date. The guidance does not impact the accounting for purchased callable debt securities held at a discount; the discount will continue to amortize to the maturity date. The guidance is effective for public entities in fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. This update is effective for us beginning June 1, 2019. Adoption of the guidance requires modified retrospection transition as of the beginning of the period of adoption through a cumulative-effect adjustment to retained earnings. We do not expect that the adoption of this guidance will have a material impact on our consolidated financial statements.

Statement of Cash Flows—Restricted Cash

In November 2016, FASB issued ASU 2016-18, Statement of Cash Flows—Restricted Cash, which addresses the presentation of restricted cash in the statement of cash flows. The guidance requires that the statement of cash flows explain the change in the beginning-of-period and end-of-period total of cash, cash equivalents and restricted cash balances. We currently explain the change during the period in total of cash and cash equivalents on our consolidated statements of cash flows. The guidance is effective for public entities in fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, and must be applied retrospectively. We adopted this guidance on June 1, 2018 with retrospective application. Beginning with the first quarter of fiscal year 2019, we will change the presentation of our consolidated statement of cash flows to explain the changes in cash and cash equivalents and restricted cash and revise prior- period amounts to conform to this presentation. We will also disclose the total for cash and cash equivalents and restricted cash on our consolidated balance sheets to correspond to the statement of cash flows.

Financial Instruments—Credit Losses: Measurement of Credit Losses on Financial Instruments

In June 2016, FASB issued ASU 2016-13, Financial Instruments—Credit Losses: Measurement of Credit Losses on Financial Instruments, which replaces the existing incurred loss impairment model and establishes a single allowance framework based on a current expected credit loss model for financial assets carried at amortized cost, including loans and held-to-maturity debt securities. The current expected loss model requires an entity to estimate the credit losses expected over the life of the credit exposure upon initial recognition of that exposure when the financial asset is originated or acquired, which will generally result in earlier recognition of credit losses. The guidance also amends the other-than-temporary model for available-for-sale debt securities by requiring the use of an allowance, rather than directly reducing the carrying value of the security. The new guidance also requires expanded credit quality disclosures. The new standard is effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2019. Early application will be permitted for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. This update is effective for us beginning June 1, 2020. We do not expect to early adopt this guidance. Upon adoption, we will be required to record a cumulative-effect adjustment to retained earnings. The impact on our consolidated financial statements from the adoption of this new guidance will depend on the composition and risk profile of our loan portfolio as of the date of adoption.

Financial Instruments—Overall: Recognition and Measurement of Financial Assets and Financial Liabilities

In January 2016, FASB issued ASU 2016-01, Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities, which amends certain aspects of the recognition, measurement, presentation and disclosure of certain financial instruments, including equity investments and liabilities measured at fair value under the fair value option. The main provisions include a requirement that all investments in equity securities be measured at fair value through earnings, with certain exceptions, and a requirement to present separately in other comprehensive income the portion of the total change in fair value attributable to an entity's own credit risk for financial liabilities where the fair value option has been elected. We adopted this guidance on June 1, 2018. Upon adoption, we recorded a cumulative-effect adjustment that

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resulted in an increase in retained earnings of $9 million and a corresponding decrease in AOCI. Beginning in the first quarter of fiscal year 2019, we will record unrealized changes in the fair value of our investments in equity securities classified as available for sale in earnings. Previously, such unrealized gains and losses were reflected in other comprehensive income.

Revenue from Contracts with Customers

In May 2014, FASB issued ASU 2014-09, Revenue from Contracts with Customers, which modifies the guidance used to recognize revenue from contracts with customers for transfers of goods or services and transfers of nonfinancial assets. This guidance applies to all contracts with customers to provide goods or services in the ordinary course of business, except for certain contracts specifically excluded from the scope, including financial instruments, guarantees, insurance contracts and leases. As a financial institution, substantially all of our revenue is in the form of interest income derived from financial instruments, primarily our investments in loans and securities. Given the scope exception for financial instruments, the guidance has no impact on our recognition and measurement of interest income and excludes the vast majority of our other transactions, such as financial guarantees and derivatives. The guidance became effective for us on June 1, 2018. Adoption of the guidance did not have an impact on our consolidated financial statements.

NOTE 2—VARIABLE INTEREST ENTITIES

NCSC and RTFC meet the definition of a VIE because they do not have sufficient equity investment at risk to finance their activities without financial support. CFC is the primary source of funding for NCSC and the sole source of funding for RTFC. Under the terms of management agreements, CFC manages the business operations of NCSC and RTFC. CFC also unconditionally guarantees full indemnification for any loan losses of NCSC and RTFC pursuant to guarantee agreements with each company. CFC earns management and guarantee fees from its agreements with NCSC and RTFC.

All loans that require NCSC board approval also require CFC board approval. CFC is not a member of NCSC and does not elect directors to the NCSC board. If CFC becomes a member of NCSC, it would control the nomination process for one NCSC director. NCSC members elect directors to the NCSC board based on one vote for each member. NCSC is a service organization member of CFC. All loans that require RTFC board approval also require approval by CFC for funding under RTFC's credit facilities with CFC. CFC is not a member of RTFC and does not elect directors to the RTFC board. RTFC is a non-voting associate of CFC. RTFC members elect directors to the RTFC board based on one vote for each member.

NCSC and RTFC creditors have no recourse against CFC in the event of a default by NCSC and RTFC, unless there is a guarantee agreement under which CFC has guaranteed NCSC or RTFC debt obligations to a third party. The following table provides information on incremental consolidated assets and liabilities of VIEs included in CFC's consolidated financial statements, after applying intercompany eliminations, as of May 31, 2018 and 2017.

| | May 31, | |
|---|---|---|
| (Dollars in thousands) | 2018 | 2017 |

| | | |
|---|---|---|
| Total loans outstanding | $1,149,574 | $968,343 |
| Other assets | 10,280 | 10,157 |
| Total assets | $1,159,854 | $978,500 |
| | | |
| Long-term debt | $8,000 | $10,000 |
| Other liabilities | 33,923 | 36,899 |
| Total liabilities | $41,923 | $46,899 |

The following table provides information on CFC's credit commitments to NCSC and RTFC, and its potential exposure to loss as of May 31, 2018 and 2017.

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| | May 31, | |
|---|---|---|
| (Dollars in thousands) | 2018 | 2017 |
| CFC credit commitments | $5,500,000 | $5,500,000 |
| Outstanding commitments: | | |
| Borrowings payable to CFC[1] | 1,116,465 | 931,686 |
| Credit enhancements: | | |
| CFC third-party guarantees | 12,005 | 14,697 |
| Other credit enhancements | 14,655 | 20,963 |
| Total credit enhancements[2] | 26,660 | 35,660 |
| Total outstanding commitments | 1,143,125 | 967,346 |
| CFC available credit commitments | $4,356,875 | $4,532,654 |

[1] Borrowings payable to CFC are eliminated in consolidation.
[2] Excludes interest due on these instruments.

CFC loans to NCSC and RTFC are secured by all assets and revenue of NCSC and RTFC. CFC's maximum potential exposure, including interest due, for the credit enhancements totaled $28 million. The maturities for obligations guaranteed by CFC extend through 2031.

NOTE 3—INVESTMENT SECURITIES

The accounting and measurement framework for investment securities differs depending on the security classification. We currently classify and account for our investment securities as either AFS or HTM based on our investment strategy and management's assessment of our intent and ability to hold the securities until maturity. See "Note 1—Summary of Significant Accounting Policies" for additional information on our investment securities.

During the second quarter of fiscal year 2018, we commenced the purchase of additional investment securities, consisting primarily of certificates of deposit with maturities greater than 90 days, commercial paper, corporate debt securities, commercial MBS and other ABS. Pursuant to our investment policy guidelines, all fixed-income securities, at the time of purchase, must be rated at least investment grade and on stable outlook based on external credit ratings from at least two of the leading global credit rating agencies, when available, or the corresponding equivalent, when not available. Securities rated investment grade, that is those rated Baa3 or higher by Moody's Investors Service ("Moody's") or BBB- or higher by S&P or BBB- or higher by Fitch Ratings Inc. ("Fitch"), are generally considered by the rating agencies to be of lower credit risk than non-investment grade securities. We have the positive intent and ability to hold these securities to maturity. As such, we have classified them as held to maturity on our consolidated balance sheets. We did not have any securities classified as HTM as of May 31, 2017.

Amortized Cost and Fair Value of Investment Securities

The following tables present the amortized cost and fair value of our investment securities and the corresponding gross unrealized gains and losses, by classification category and major security type, as of May 31, 2018 and 2017.

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| | May 31, 2018 | | | |
|---|---|---|---|---|
| (Dollars in thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Available for sale: | | | | |
| Farmer Mac—series A non-cumulative preferred stock | $30,000 | $ 480 | $ — | $30,480 |
| Farmer Mac—series B non-cumulative preferred stock | 25,000 | 1,000 | — | 26,000 |
| Farmer Mac—series C non-cumulative preferred stock | 25,000 | 872 | — | 25,872 |
| Farmer Mac—class A common stock | 538 | 6,442 | — | 6,980 |
| Total investment securities, available for sale | 80,538 | 8,794 | — | 89,332 |
| Held to maturity: | | | | |
| Certificates of deposit | 4,148 | — | — | 4,148 |
| Commercial paper | 9,134 | — | — | 9,134 |
| U.S. agency debt securities | 2,000 | 16 | — | 2,016 |
| Corporate debt securities | 455,721 | 714 | (4,595) | 451,840 |
| Commercial MBS: | | | | |
| Agency | 7,024 | 63 | — | 7,087 |
| Non-agency | 3,453 | 3 | (3) | 3,453 |
| Total commercial MBS | 10,477 | 66 | (3) | 10,540 |
| U.S. state and municipality debt securities | 2,147 | 24 | — | 2,171 |
| Foreign government debt securities | 1,241 | 9 | — | 1,250 |
| Other ABS[1] | 34,651 | 11 | (215) | 34,447 |
| Total investment securities, held to maturity | 519,519 | 840 | (4,813) | 515,546 |
| Total investment securities | $600,057 | $ 9,634 | $ (4,813) | $604,878 |

———————————————

[1]Consists primarily of securities backed by auto lease loans, equipment-backed loans, auto loans and credit card loans.

| | May 31, 2017 | | | |
|---|---|---|---|---|
| (Dollars in thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Available for sale: | | | | |
| Farmer Mac—series A non-cumulative preferred stock | $30,000 | $ 1,585 | $ — | $31,585 |
| Farmer Mac—series B non-cumulative preferred stock | 25,000 | 1,940 | — | 26,940 |
| Farmer Mac—series C non-cumulative preferred stock | 25,000 | 4,150 | — | 29,150 |
| Farmer Mac—class A common stock | 538 | 4,341 | — | 4,879 |
| Total investment securities, available for sale | $80,538 | $ 12,016 | $ — | $92,554 |

For additional information on the unrealized gains (losses) losses recorded on our AFS investment securities, see “Note 10—Equity—Accumulated Other Comprehensive Income.”

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Investment Securities in Gross Unrealized Loss Position

An unrealized loss exists when the current fair value of an individual security is less than its amortized cost basis. The following table presents the fair value and gross unrealized losses for investments in a gross loss position, aggregated by security type, and the length of time the securities have been in a continuous unrealized loss position as of May 31, 2018. The securities are segregated between investments that have been in a continuous unrealized loss position for less than 12 months and 12 months or more based on the point in time that the fair value declined below the amortized cost basis. We did not have any investment securities in a gross unrealized loss position as of May 31, 2017.

| | May 31, 2018 | | | | | |
|---|---|---|---|---|---|---|
| | Unrealized Loss Position Less than 12 Months | | Unrealized Loss Position 12 Months or Longer | | Total | |
| (Dollars in thousands) | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Held to maturity: | | | | | | |
| Corporate debt securities | $280,139 | $ (4,595) | $ — | $ — | $280,139 | $ (4,595) |
| Commercial MBS, non-agency | 1,451 | (3) | — | — | 1,451 | (3) |
| Other ABS[(1)] | 27,012 | (215) | — | — | 27,012 | (215) |
| Total investment securities | $308,602 | $ (4,813) | $ — | $ — | $308,602 | $ (4,813) |

[(1)]Consists primarily of securities backed by auto lease loans, equipment-backed loans, auto loans and credit card loans.

Other-Than-Temporary Impairment

We conduct periodic reviews of all securities with unrealized losses to evaluate whether the impairment is other than temporary. The number of individual securities in an unrealized loss position was 225 as of May 31, 2018. We have assessed each security with gross unrealized losses included in the above table for credit impairment. As part of that assessment, we concluded that the unrealized losses are driven by changes in market interest rates rather than by adverse changes in the credit quality of these securities. Based on our assessment, we expect to recover the entire amortized cost basis of these securities, as we do not intend to sell any of the securities and have concluded that it is more likely than not that we will not be required to sell prior to recovery of the amortized cost basis. Accordingly, we currently consider the impairment of these securities to be temporary.

Contractual Maturity and Yield

The following table presents, by major security type, the remaining contractual maturity based on amortized cost and fair value as of May 31, 2018 of our HTM investment securities. Because borrowers may have the right to call or prepay certain obligations, the expected maturities of our investments may differ from the scheduled contractual maturities presented below.

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| | May 31, 2018 | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | Due in 1 Year or Less | Due >1 Year through 5 Years | Due >5 Years through 10 Years | Due >10 Years | Total |
| Amortized cost: | | | | | |
| Certificates of deposit | $4,148 | $— | $— | $— | $4,148 |
| Commercial paper | 9,134 | — | — | — | 9,134 |
| U.S. agency debt securities | — | 2,000 | — | — | 2,000 |
| Corporate debt securities | 9,111 | 377,384 | 69,226 | — | 455,721 |
| Commercial MBS: | | | | | |
| Agency | — | — | 7,024 | — | 7,024 |
| Non-agency | — | — | — | 3,453 | 3,453 |
| Total commercial MBS | — | — | 7,024 | 3,453 | 10,477 |
| U.S. state and municipality debt securities | — | — | 2,147 | — | 2,147 |
| Foreign government debt securities | — | 1,241 | — | — | 1,241 |
| Other ABS[1] | — | 33,357 | 1,294 | — | 34,651 |
| Total | $22,393 | $413,982 | $79,691 | $3,453 | $519,519 |
| | | | | | |
| Fair value: | | | | | |
| Certificates of deposit | $4,148 | $— | $— | $— | $4,148 |
| Commercial paper | 9,134 | — | — | — | 9,134 |
| U.S. agency debt securities | — | 2,016 | — | — | 2,016 |
| Corporate debt securities | 9,056 | 373,284 | 69,500 | — | 451,840 |
| Commercial MBS: | | | | | |
| Agency | — | — | 7,087 | — | 7,087 |
| Non-agency | — | — | — | 3,453 | 3,453 |
| Total commercial MBS | — | — | 7,087 | 3,453 | 10,540 |
| U.S. state and municipality debt securities | — | — | 2,171 | — | 2,171 |
| Foreign government debt securities | — | 1,250 | — | — | 1,250 |
| Other ABS[1] | — | 33,157 | 1,290 | — | 34,447 |
| Total | $22,338 | $409,707 | $80,048 | $3,453 | $515,546 |
| | | | | | |
| Weighted-average coupon[2] | 1.81 % | 2.84 % | 3.60 % | 2.74 % | 2.91 % |

[1]Consists primarily of securities backed by auto lease loans, equipment-backed loans, auto loans and credit card loans.
[2]Calculated based on the weighted-average coupon rate, which excludes the impact of amortization of premium and accretion of discount.

The average contractual maturity and weighted-average coupon of our HTM investment securities was four years and 2.91%, respectively, as of May 31, 2018. The average credit rating of these securities, based on the equivalent lowest credit rating by Moody's, S&P and Fitch was A- as of May 31, 2018.

Realized Gains and Losses

We did not sell any of our investment securities during the year ended May 31, 2018 and May 31, 2017, and therefore have not recorded any realized gains or losses.

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NOTE 4—LOANS

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are considered loans held for investment. The loans presented on our consolidated balance sheet are classified and accounted for as held for investment. Loans held for investment are carried at the outstanding unpaid principal balance, net of unamortized loan origination costs.

We offer fixed- and variable-rate loans and line of credit loans. Borrowers may choose between a fixed interest rate or a variable interest rate for periods of one to 35 years. When a selected fixed interest rate term expires, the borrower may select another fixed-rate term or a variable rate. We consider these fixed- and variable-rate loans, which have repricing terms, as long-term loans. Collateral and security requirements for advances on loan commitments are identical to those required at the time of the initial loan approval.

The following table presents the outstanding principal balance of loans to members, including deferred loan origination costs, and unadvanced loan commitments by loan type and member class, as of May 31, 2018 and 2017.

| | May 31, 2018 | | 2017 | |
|---|---|---|---|---|
| (Dollars in thousands) | Loans Outstanding | Unadvanced Commitments (1) | Loans Outstanding | Unadvanced Commitments (1) |
| Loan type: | | | | |
| Long-term loans: | | | | |
| Fixed rate | $22,696,185 | $— | $22,136,690 | $— |
| Variable rate | 1,039,491 | 4,952,834 | 847,419 | 4,802,319 |
| Total long-term loans | 23,735,676 | 4,952,834 | 22,984,109 | 4,802,319 |
| Lines of credit | 1,431,818 | 7,692,784 | 1,372,221 | 7,772,655 |
| Total loans outstanding | 25,167,494 | 12,645,618 | 24,356,330 | 12,574,974 |
| Deferred loan origination costs | 11,114 | — | 10,714 | — |
| Loans to members | $25,178,608 | $12,645,618 | $24,367,044 | $12,574,974 |
| | | | | |
| Member class: | | | | |
| CFC: | | | | |
| Distribution | $19,551,511 | $8,188,376 | $18,825,366 | $8,295,146 |
| Power supply | 4,397,353 | 3,407,095 | 4,504,791 | 3,276,113 |
| Statewide and associate | 69,055 | 128,025 | 57,830 | 144,406 |
| Total CFC | 24,017,919 | 11,723,496 | 23,387,987 | 11,715,665 |
| NCSC | 786,457 | 624,663 | 613,924 | 584,944 |
| RTFC | 363,118 | 297,459 | 354,419 | 274,365 |
| Total loans outstanding | 25,167,494 | 12,645,618 | 24,356,330 | 12,574,974 |
| Deferred loan origination costs | 11,114 | — | 10,714 | — |

| | | | | |
|---|---|---|---|---|
| Loans to members | $25,178,608 | $12,645,618 | $24,367,044 | $12,574,974 |

______________________

(1)The interest rate on unadvanced loan commitments is not set until an advance is made; therefore, all long-term unadvanced loan commitments are reported as variable-rate. However, the borrower may select either a fixed or a variable rate when an advance on a commitment is made.

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Unadvanced Loan Commitments

Unadvanced loan commitments represent approved and executed loan contracts for which funds have not been advanced to borrowers. The following table summarizes the available balance under unadvanced loan commitments as of May 31, 2018 and the related maturities, by fiscal year and thereafter, by loan type:

| | Available | Notional Maturities of Unadvanced Loan Commitments | | | | | |
|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | Balance | 2019 | 2020 | 2021 | 2022 | 2023 | Thereafter |
| Line of credit loans | $7,692,784 | $4,168,751 | $710,763 | $805,508 | $770,971 | $1,211,791 | $ 25,000 |
| Long-term loans | 4,952,834 | 883,840 | 586,005 | 652,499 | 1,714,338 | 1,104,185 | 11,967 |
| Total | $12,645,618 | $5,052,591 | $1,296,768 | $1,458,007 | $2,485,309 | $2,315,976 | $ 36,967 |

Unadvanced line of credit commitments accounted for 61% of total unadvanced loan commitments as of May 31, 2018, while unadvanced long-term loan commitments accounted for 39% of total unadvanced loan commitments. Unadvanced line of credit commitments are typically revolving facilities for periods not to exceed five years. Unadvanced line of credit commitments generally serve as supplemental back-up liquidity to our borrowers. Historically, borrowers have not drawn the full commitment amount for line of credit facilities, and we have experienced a very low utilization rate on line of credit loan facilities regardless of whether or not we are obligated to fund the facility where a material adverse change exists.

Our unadvanced long-term loan commitments have a five-year draw period under which a borrower may advance funds prior to the expiration of the commitment. We expect that the majority of the long-term unadvanced loan commitments of $4,953 million will be advanced prior to the expiration of the commitment.

Because we historically have experienced a very low utilization rate on line of credit loan facilities, which account for the majority of our total unadvanced loan commitments, we believe the unadvanced loan commitment total of $12,646 million as of May 31, 2018 is not necessarily representative of our future funding cash requirements.

Unadvanced Loan Commitments—Conditional

The substantial majority of our line of credit commitments and all of our unadvanced long-term loan commitments include material adverse change clauses. Unadvanced loan commitments subject to material adverse change clauses totaled $9,789 million and $9,973 million as of May 31, 2018 and 2017, respectively. Prior to making an advance on these facilities, we confirm that there has been no material adverse change in the business or condition, financial or otherwise, of the borrower since the time the loan was approved and confirm that the borrower is currently in compliance with loan terms and conditions. In some cases, the borrower’s access to the full amount of the facility is further constrained by the designated purpose, imposition of borrower-specific restrictions or by additional conditions that must be met prior to advancing funds.

Unadvanced Loan Commitments—Unconditional

Unadvanced loan commitments not subject to material adverse change clauses at the time of each advance consisted of unadvanced committed lines of credit totaling $2,857 million and $2,602 million as of May 31, 2018 and 2017, respectively. As such, we are required to advance amounts on these committed facilities as long as the borrower is in compliance with the terms and conditions of the facility.

The following table summarizes the available balance under unconditional committed lines of credit as of May 31, 2018, and maturities by fiscal year.

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| (Dollars in thousands) | Available Balance | Notional Maturities of Unconditional Committed Lines of Credit 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| Committed lines of credit | $2,857,350 | $279,285 | $435,151 | $444,326 | $644,178 | $1,054,410 |

Loan Sales

We transfer, from time to time, loans to third parties under our direct loan sale program. Our transfer of loans, which is at par value and sold concurrently with loan closing, meets the applicable accounting criteria for sale accounting. Accordingly, we remove the loans from our consolidated balance sheets when control has been surrendered and recognize a gain or loss. We retain the servicing performance obligations on these loans and recognize related servicing fees on an accrual basis over the period for which servicing activity is provided, as we believe the servicing fee represents adequate compensation. We do not hold any continuing interest in the loans sold to date other than servicing performance obligations. We have no obligation to repurchase loans from the purchaser, except in the case of breaches of representations and warranties.

We sold CFC loans with outstanding balances totaling $119 million, $58 million and $99 million at par for cash in fiscal years 2018, 2017 and 2016, respectively. We recorded immaterial losses upon the sale of these loans, attributable to the unamortized deferred loan origination costs associated with the transferred loans.

Pledging of Loans

We are required to pledge eligible mortgage notes in an amount at least equal to the outstanding balance of our secured debt.

The following table summarizes our loans outstanding as collateral pledged to secure our collateral trust bonds, Clean Renewable Energy Bonds, notes payable to Farmer Mac and notes payable under the Guaranteed Underwriter Program of the USDA (“Guaranteed Underwriter Program”) and the amount of the corresponding debt outstanding as of May 31, 2018 and 2017. See “Note 5—Short-Term Borrowings” and “Note 6—Long-Term Debt” for information on our borrowings.

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| | May 31, | |
|---|---|---|
| (Dollars in thousands) | 2018 | 2017 |
| Collateral trust bonds: | | |
| 2007 indenture: | | |
| Distribution system mortgage notes | $8,643,344 | $8,740,572 |
| RUS-guaranteed loans qualifying as permitted investments | 140,680 | 146,373 |
| Total pledged collateral | $8,784,024 | $8,886,945 |
| Collateral trust bonds outstanding | 7,697,711 | 7,697,711 |
| | | |
| 1994 indenture: | | |
| Distribution system mortgage notes | $243,418 | $263,007 |
| Collateral trust bonds outstanding | 220,000 | 225,000 |
| | | |
| Farmer Mac: | | |
| Distribution and power supply system mortgage notes | $3,331,775 | $2,942,456 |
| Notes payable outstanding | 2,891,496 | 2,513,389 |
| | | |
| Clean Renewable Energy Bonds Series 2009A: | | |
| Distribution and power supply system mortgage notes | $12,615 | $14,943 |
| Cash | 415 | 481 |
| Total pledged collateral | $13,030 | $15,424 |
| Notes payable outstanding | 11,556 | 13,214 |
| | | |
| Federal Financing Bank: | | |
| Distribution and power supply system mortgage notes | $5,772,750 | $5,833,515 |
| Notes payable outstanding | 4,856,375 | 4,985,748 |

Credit Concentration

As a tax-exempt, member-owned finance cooperative, CFC's principal focus is to provide funding to its rural electric utility cooperative members to assist them in acquiring, constructing and operating electric distribution, power supply systems and related facilities. We serve electric and telecommunications members throughout the United States and its territories, including 50 states, the District of Columbia, American Samoa and Guam. Our consolidated membership totaled 1,449 members and 216 associates as of May 31, 2018. Texas had the largest concentration of outstanding loans to borrowers in any one state, with approximately 15% of total loans outstanding as of both May 31, 2018 and 2017. As a result of lending primarily to our rural electric utility cooperative members we have a loan portfolio subject to single-industry and single-obligor concentration risks. Despite our credit concentration risks, we historically have experienced limited defaults and very low credit losses in our electric loan portfolio.

Loans outstanding to electric utility organizations represented approximately 99% of total loans outstanding as of May 31, 2018, unchanged from May 31, 2017. The remaining loans outstanding in our portfolio were to RTFC members, affiliates and associates in the telecommunications industry. The combined exposure of loans and guarantees outstanding for our 20 largest borrowers represented 23% and 24% of our total combined exposure as of May 31, 2018 and 2017, respectively. The 20 largest borrowers consisted of nine distribution systems, 10 power supply systems and one NCSC associate member as of May 31, 2018. The 20 largest borrowers consisted of 10 distribution systems, nine power supply systems and one NCSC associate member as of May 31, 2017. The largest total loan and guarantee outstanding exposure to

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a single borrower or controlled group represented approximately 2% of total loans and guarantees outstanding as of both May 31, 2018 and 2017.

Credit Quality

We closely monitor loan performance trends to manage and evaluate our credit risk exposure. We seek to provide a balance between meeting the credit needs of our members while also ensuring the sound credit quality of our loan portfolio. Payment status and internal risk ratings are key indicators, among others, of the level of credit risk in our loan portfolio.

Except when providing line of credit loans, we generally lend to our members on a senior secured basis. Long-term loans are generally secured on parity with other secured lenders (primarily RUS), if any, by all assets and revenue of the borrower with exceptions typical in utility mortgages. Line of credit loans are generally unsecured. In addition to the collateral pledged to secure our loans, distribution and power supply borrowers also are required to set rates charged to customers to achieve certain specified financial ratios.

As part of our strategy in managing our credit risk exposure, we entered into a long-term standby purchase commitment agreement with Farmer Mac during fiscal year 2016. Under this agreement, we may designate certain long-term loans to be covered under the commitment, subject to approval by Farmer Mac, and in the event any such loan later goes into payment default for at least 90 days, upon request by us, Farmer Mac must purchase such loan at par value. The aggregate unpaid principal balance of designated and Farmer Mac approved loans was $660 million and $843 million as of May 31, 2018 and 2017, respectively. Under the agreement, we are required to pay Farmer Mac a monthly fee based on the unpaid principal balance of loans covered under the purchase commitment. No loans had been put to Farmer Mac for purchase, pursuant to this agreement, as of May 31, 2018. Also, we had long-term loans totaling $161 million and $167 million as of May 31, 2018 and 2017, respectively, guaranteed by RUS.

Payment Status of Loans

The tables below present the payment status of loans outstanding by member class as of May 31, 2018 and 2017. As indicated in the table, we did not have any past due loans as of either May 31, 2018 or May 31, 2017.

| | May 31, 2018 | | | | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Current | 30-89 Days Past Due | 90 Days or More Past Due (1) | Total Past Due | Total Loans Outstanding | Nonaccrual Loans |
| CFC: | | | | | | |
| Distribution | $19,551,511 | $ — | $ — | $ — | $19,551,511 | $ — |

| | | | | | | |
|---|---|---|---|---|---|---|
| Power supply | 4,397,353 | — | — | — | 4,397,353 | — |
| Statewide and associate | 69,055 | — | — | — | 69,055 | — |
| CFC total | 24,017,919 | — | — | — | 24,017,919 | — |
| NCSC | 786,457 | — | — | — | 786,457 | — |
| RTFC | 363,118 | — | — | — | 363,118 | — |
| Total loans outstanding | $25,167,494 | $ — | $ — | $ — | $25,167,494 | $ — |
| Percentage of total loans | 100.00 % | —% | —% | —% | 100.00 % | — % |

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| | May 31, 2017 | | | | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Current | 30-89 Days Past Due | 90 Days or More Past Due (1) | Total Past Due | Total Loans Outstanding | Nonaccrual Loans |
| CFC: | | | | | | |
| Distribution | $18,825,366 | $ — | $ — | $ — | $18,825,366 | $ — |
| Power supply | 4,504,791 | — | — | — | 4,504,791 | — |
| Statewide and associate | 57,830 | — | — | — | 57,830 | — |
| CFC total | 23,387,987 | — | — | — | 23,387,987 | — |
| NCSC | 613,924 | — | — | — | 613,924 | — |
| RTFC | 354,419 | — | — | — | 354,419 | — |
| Total loans outstanding | $24,356,330 | $ — | $ — | $ — | $24,356,330 | $ — |
| Percentage of total loans | 100.00 % | —% | —% | —% | 100.00 % | — % |

(1) All loans 90 days or more past due are on nonaccrual status.

Troubled Debt Restructurings

We did not have any loans modified as TDRs during the year ended May 31, 2018. The following table provides a summary of loans modified as TDRs in prior periods, the performance status of these loans and the unadvanced loan commitments related to the TDR loans, by member class, as of May 31, 2018 and 2017.

| | May 31, 2018 | | | 2017 | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Loans Outstanding | % of Total Loans | Unadvanced Commitments | Loans Outstanding | % of Total Loans | Unadvanced Commitments |
| TDR loans: | | | | | | |
| Performing TDR loans: | | | | | | |
| CFC/Distribution | $6,507 | 0.03 % | $ — | $6,581 | 0.02 % | $ — |
| RTFC | 6,092 | 0.02 % | — | 6,592 | 0.03 | — |
| Total performing TDR loans | 12,599 | 0.05 % | — | 13,173 | 0.05 | — |
| Total TDR loans | $12,599 | 0.05 % | $ — | $13,173 | 0.05 % | $ — |

We did not have any TDR loans classified as nonperforming as of May 31, 2018 or May 31, 2017. TDR loans classified as performing as of May 31, 2018 and 2017 were performing in accordance with the terms of their respective restructured loan agreement and on accrual status as of the respective reported dates. One borrower with a TDR loan also had a line of credit facility, restricted for fuel purchases only, totaling $6 million as of both May 31, 2018 and 2017. The outstanding amount under this facility totaled less than $1 million as of both May 31, 2018 and 2017, and was classified as performing as of each respective date.

Nonperforming Loans

In addition to TDR loans that may be classified as nonperforming, we also may have nonperforming loans that have not been modified as a TDR. We did not have any loans classified as nonperforming as of either May 31, 2018 or May 31, 2017.

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The following table shows foregone interest income for loans on nonaccrual status for the fiscal years ended May 31, 2018, 2017 and 2016.

| | Year Ended May 31, | | |
|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2016 |
| Performing TDR loans | $— | $— | $166 |
| Nonperforming TDR loans | — | 31 | 109 |
| Total | $— | $31 | $275 |

Impaired Loans

The following table provides information on loans classified as individually impaired as of May 31, 2018 and 2017.

| | May 31, | | | |
|---|---|---|---|---|
| | 2018 | | 2017 | |
| (Dollars in thousands) | Recorded Investment | Related Allowance | Recorded Investment | Related Allowance |
| With no specific allowance recorded: | | | | |
| CFC | $6,507 | $ — | $6,581 | $ — |
| With a specific allowance recorded: | | | | |
| RTFC | 6,092 | 1,198 | 6,592 | 1,640 |
| Total impaired loans | $12,599 | $ 1,198 | $13,173 | $ 1,640 |

The following table presents, by company, the average recorded investment for individually impaired loans and the interest income recognized on these loans for fiscal years ended May 31, 2018, 2017 and 2016.

| | Average Recorded Investment | | | Interest Income Recognized | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | 2018 | 2017 | 2016 | 2018 | 2017 | 2016 |
| CFC | $6,524 | $6,613 | $6,842 | $571 | $562 | $390 |
| RTFC | 6,361 | 7,736 | 9,823 | 318 | 343 | 264 |
| Total impaired loans | $12,885 | $14,349 | $16,665 | $889 | $905 | $654 |

Internal Risk Ratings of Loans

As part of our credit risk management process, we monitor and evaluate each borrower and loan in our loan portfolio and assign internal borrower and loan facility risk ratings based on quantitative and qualitative assessments. Our borrower risk ratings are intended to assess probability of default. Each risk rating is reassessed annually following the receipt of the borrower's audited financial statements; however, interim risk-rating downgrades or upgrades may occur as a result of significant developments or trends. Our borrower risk ratings are aligned with banking regulatory agency credit risk rating definitions of pass and criticized classifications, with criticized divided between special mention, substandard and doubtful. Pass ratings reflect relatively low probability of default, while criticized ratings have a higher probability of default. Following is a description of each rating category.

- Pass: Borrowers that are not experiencing difficulty and/or not showing a potential or well-defined credit weakness.
- Special Mention: Borrowers that may be characterized by a potential credit weakness or deteriorating financial condition that is not sufficiently serious to warrant a classification of substandard or doubtful.

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- Substandard: Borrowers that display a well-defined credit weakness that may jeopardize the full collection of principal and interest.
- Doubtful: Borrowers that have a well-defined credit weakness or weaknesses that make full collection of principal and interest, on the basis of currently known facts, conditions and collateral values, highly questionable and improbable.

Loans to borrowers in the pass, special mention and substandard categories are generally considered not to be individually impaired and are included in the loan pools for determining the collective reserve component of the allowance for loan losses. Loans to borrowers in the doubtful category are considered to be impaired and are therefore individually assessed for impairment in determining the specific reserve component of the allowance for loan losses.

The following tables present total loans outstanding, by member class and borrower risk-rating category, based on the risk ratings used in the estimation of our allowance for loan losses as of May 31, 2018 and 2017.

| | May 31, 2018 | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | Pass | Special Mention | Substandard | Doubtful | Total |
| CFC: | | | | | |
| Distribution | $19,429,121 | $ 6,853 | $ 115,537 | $ — | $19,551,511 |
| Power supply | 4,348,328 | — | 49,025 | — | 4,397,353 |
| Statewide and associate | 69,055 | — | — | — | 69,055 |
| CFC total | 23,846,504 | 6,853 | 164,562 | — | 24,017,919 |
| NCSC | 786,457 | — | — | — | 786,457 |
| RTFC | 356,503 | 523 | 6,092 | — | 363,118 |
| Total loans outstanding | $24,989,464 | $ 7,376 | $ 170,654 | $ — | $25,167,494 |

| | May 31, 2017 | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | Pass | Special Mention | Substandard | Doubtful | Total |
| CFC: | | | | | |
| Distribution | $18,715,810 | $109,556 | $ — | $ — | $18,825,366 |
| Power supply | 4,504,791 | — | — | — | 4,504,791 |
| Statewide and associate | 56,654 | 1,176 | — | — | 57,830 |
| CFC total | 23,277,255 | 110,732 | — | — | 23,387,987 |
| NCSC | 612,592 | 1,332 | — | — | 613,924 |
| RTFC | 346,944 | — | 7,475 | — | 354,419 |
| Total loans outstanding | $24,236,791 | $112,064 | $ 7,475 | $ — | $24,356,330 |

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The increase in loans classified as substandard of $163 million was attributable to the downgrade of an electric distribution cooperative and its subsidiary as of May 31, 2018. The electric distribution cooperative provides its customers with distribution and transmission services and is in the early stages of deploying retail broadband service. The borrower is currently experiencing financial difficulties due to recent net losses and weak cash flows. Pursuant to our risk rating guidelines, the borrower's current financial condition warranted a downgrade to a substandard rating as of May 31, 2018. The borrower and its subsidiary are current with regard to all principal and interest payments and have never been delinquent. The borrower operates in a territory that is not rate-regulated and has the ability to adjust its electric rates to cover operating costs and service debt. Of the outstanding amount, all but $7 million is secured under our typical collateral requirements for long-term loan advances. We currently expect to collect all principal and interest amounts due from the borrower and its subsidiary. Accordingly, the loans outstanding to this borrower and its subsidiary were not deemed to be impaired as of May 31, 2018.

Allowance for Loan Losses

The following tables summarize changes, by company, in the allowance for loan losses as of and for the years ended May 31, 2018, 2017 and 2016.

| | Year Ended May 31, 2018 | | | |
|---|---|---|---|---|
| (Dollars in thousands) | CFC | NCSC | RTFC | Total |
| Balance as of May 31, 2017 | $29,499 | $2,910 | $4,967 | $37,376 |
| Benefit for loan losses | (17,199 ) | (828 ) | (548 ) | (18,575 ) |
| Balance as of May 31, 2018 | $12,300 | $2,082 | $4,419 | $18,801 |

| | Year Ended May 31, 2017 | | | |
|---|---|---|---|---|
| (Dollars in thousands) | CFC | NCSC | RTFC | Total |
| Balance as of May 31, 2016 | $24,559 | $3,134 | $5,565 | $33,258 |
| Provision (benefit) for loan losses | 4,781 | (224 ) | 1,421 | 5,978 |
| Charge-offs | — | — | (2,119 ) | (2,119 ) |
| Recoveries | 159 | — | 100 | 259 |
| Net (charge-offs) recoveries | 159 | — | (2,019 ) | (1,860 ) |
| Balance as of May 31, 2017 | $29,499 | $2,910 | $4,967 | $37,376 |

| | Year Ended May 31, 2016 | | | |
|---|---|---|---|---|
| (Dollars in thousands) | CFC | NCSC | RTFC | Total |
| Balance as of May 31, 2015 | $23,716 | $5,441 | $4,533 | $33,690 |
| Provision (benefit) for loan losses | 629 | (2,307 ) | 1,032 | (646 ) |
| Recoveries | 214 | — | — | 214 |
| Balance as of May 31, 2016 | $24,559 | $3,134 | $5,565 | $33,258 |

The tables below present, by company, the components of our allowance for loan losses and the recorded investment of the related loans as of May 31, 2018 and 2017.

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| | May 31, 2018 | | | |
|---|---|---|---|---|
| (Dollars in thousands) | CFC | NCSC | RTFC | Total |
| Ending balance of the allowance: | | | | |
| Collective allowance | $12,300 | $2,082 | $3,221 | $17,603 |
| Specific allowance | — | — | 1,198 | 1,198 |
| Total ending balance of the allowance | $12,300 | $2,082 | $4,419 | $18,801 |
| | | | | |
| Recorded investment in loans: | | | | |
| Collectively evaluated loans | $24,011,412 | $786,457 | $357,026 | $25,154,895 |
| Individually evaluated loans | 6,507 | — | 6,092 | 12,599 |
| Total recorded investment in loans | $24,017,919 | $786,457 | $363,118 | $25,167,494 |
| | | | | |
| Total recorded investment in loans, net (1) | $24,005,619 | $784,375 | $358,699 | $25,148,693 |

| | May 31, 2017 | | | |
|---|---|---|---|---|
| (Dollars in thousands) | CFC | NCSC | RTFC | Total |
| Ending balance of the allowance: | | | | |
| Collective allowance | $29,499 | $2,910 | $3,327 | $35,736 |
| Specific allowance | — | — | 1,640 | 1,640 |
| Total ending balance of the allowance | $29,499 | $2,910 | $4,967 | $37,376 |
| | | | | |
| Recorded investment in loans: | | | | |
| Collectively evaluated loans | $23,381,406 | $613,924 | $347,827 | $24,343,157 |
| Individually evaluated loans | 6,581 | — | 6,592 | 13,173 |
| Total recorded investment in loans | $23,387,987 | $613,924 | $354,419 | $24,356,330 |
| | | | | |
| Total recorded investment in loans, net(1) | $23,358,488 | $611,014 | $349,452 | $24,318,954 |

———————————

(1) Excludes unamortized deferred loan origination costs of $11 million as of both May 31, 2018 and 2017.

In the fourth quarter of fiscal year 2018, we increased the recovery rate assumptions used in determining the collective allowance for our electric distribution and power supply loan portfolios to reflect management's updated assessment of expected recovery rates in the event of a borrower default. The increase in recovery rate assumptions for these loan portfolios was the primary driver of the $18 million reduction in our allowance for loan losses to $19 million as of May 31, 2018, from $37 million as of May 31, 2017. Our electric utility loan portfolio has continued to exhibit strong credit performance. In fiscal year 2018, for the fifth consecutive fiscal year, we had no payment defaults, charge-offs, delinquent loans or nonperforming loans in our electric utility loan portfolio. Although we downgraded one electric distribution cooperative and its subsidiary, which had combined total loans outstanding of $165 million, to substandard as of May 31, 2018, we believe that, in the event of default, we would recover substantially all of the outstanding amount based on the historical average recovery rates for defaulted loans in our electric distribution and power supply loan portfolios.

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Reserve for Unadvanced Commitments

We also maintain a reserve for unadvanced loan commitments at a level estimated by management to provide for probable losses under these commitments as of each balance sheet date. Unadvanced loan commitments are analyzed and segregated by loan type and risk using our internal risk-rating scales. We use these risk classifications, in combination with the probability of commitment usage, and any other pertinent information to estimate a reserve for unadvanced loan commitments, which we record as a component of other liabilities on our consolidated balance sheets. The reserve for these commitments was less than $1 million as of both May 31, 2018 and 2017.

NOTE 5—SHORT-TERM BORROWINGS

The following table provides comparative information on our short-term borrowings and weighted-average interest rates as of May 31, 2018 and 2017.

| | May 31, 2018 | | 2017 | |
|---|---|---|---|---|
| (Dollars in thousands) | Amount | Weighted-Average Interest Rate | Amount | Weighted-Average Interest Rate |
| Short-term borrowings: | | | | |