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Ratings

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National Rural Utilities Cooperative Finance Corp.

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National Rural Utilities Cooperative Finance Corp.

Ratings Score Snapshot

Issuer Credit Rating
A-/Stable/A-2

SACP: a- → **Support: 0** → **Additional factors: 0**

Anchor	bbb-	
Business position	Very strong	+2
Capital and earnings	Adequate	0
Risk position	Adequate	0
Funding	Adequate	0
Liquidity	Adequate	
CRA adjustment		+1

ALAC support	0
GRE support	0
Group support	0
Sovereign support	0

Issuer credit rating
A-/Stable/A-2

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

Credit Highlights

Overview

Key strengths	Key risks
Very strong business stability owing to decades of providing financing to member electric utility cooperatives.	Relatively high non-risk-adjusted leverage and modest earnings.
Low credit risk of electric utility loans.	Single-borrower and industry concentrations.
Access to low-cost funding from the Federal Financing Bank, Farmer Mac, and members.	

Our ratings on National Rural Utilities Cooperative Finance Corp. (CFC) reflect its very strong business stability. This stability stems from decades of providing financing to member electric utility cooperatives, the low credit risk of electric utility loans, and access to low-cost funding from the Federal Financing Bank, Farmer Mac, and members. Conversely, our ratings also reflect the company's relatively high gross leverage, modest earnings, and single-borrower and industry concentrations in its loan portfolio.

We rate all of the company's senior secured and senior unsecured debt the same as the issuer credit rating. We also rate the company's subordinated deferrable debt 'BBB', two notches below the issuer credit rating, to reflect subordination and interest deferral risks.

Outlook

The stable outlook reflects S&P Global Ratings' expectations that CFC will maintain a risk-adjusted capital (RAC) ratio of 7% or better with adequate funding and liquidity for the next 18-24 months, while maintaining its role as an important source of financing for the rural electric utility industry.

Downside scenario

We could lower our ratings over the next 18-24 months if the company's RAC ratio declines to below 7% on a consistent basis, perhaps due to unexpectedly large credit losses. We could also lower the ratings if the company's unique business position erodes or its liquidity weakens.

Upside scenario

We could raise our ratings over the same period if CFC's RAC ratio rises well above 10%, the company maintains minimal credit losses, and it retains continued access to funding from the Federal Financing Bank, Farmer Mac, and members. The company's concentrated business model and use of short-term debt limit the probability of a higher rating.

Company Description

CFC is a tax-exempt, member-owned cooperative that provides credit to rural electric cooperatives and rural utilities. It has played an important role for decades in financing the rural electric utility industry--even though it is not government sponsored--because many of its members have limited direct access to the capital markets.

Anchor: Raised By One Notch To Reflect Its Unique Competitive Position Among Finance Companies

Our starting point--or anchor--for our ratings on nonbank financial institution finance companies in the U.S. is currently 'bb+'. We initially set the anchor for finance companies three notches below the anchor for banks in the same country to reflect the typical lack of central bank access, lower regulatory oversight, and higher competitive risk for finance companies than for banks. U.S. finance companies typically rely on bank facilities, secured and unsecured debt, and other wholesale funding, whereas U.S. banks mainly rely on deposit funding.

While consumer finance companies generally are subject to consumer protection laws, U.S. finance companies are not subject to the same significant prudential regulatory oversight as banks' capital and liquidity, which we view as generally supportive of creditworthiness. U.S. finance companies may compete with banks, but they often focus on higher-risk lending than banks and are subject to greater cyclical volatility. As with banks, our anchor for U.S. finance companies reflects the country's diverse and high-income economy.

Given CFC's unique competitive position, with lower risk than other finance companies, we raise the finance company anchor one notch to 'bbb-'. CFC supplements financing offered by the Rural Utilities Service (RUS) to nonprofit rural electric utilities and has few direct competitors. Additionally, CFC has access to low-cost government funding from the Federal Financing Bank and low-cost funding from Farmer Mac, a government-sponsored enterprise.

Business Position: Strong Market Position In Lending To Rural Electric Utility Cooperatives

CFC makes loans to its members so they can acquire, construct, and operate electric distribution, generation, transmission, and related facilities. Its members are dispersed throughout the U.S. and its territories and often borrow from the RUS. CFC and its primary competitor, CoBank ACB, meet most of these electric cooperatives' supplementary financing needs. Some members borrow from CFC even when they have additional capacity with the RUS, and an increasing number have been borrowing solely from CFC.

We believe CFC's focus on and knowledge of the industry, as well as some of the ancillary services it provides to members, have engendered loyalty over many years. As of May 31, 2024, CFC had 1,167 members and 512 associates. As a member-owned cooperative, CFC's objective is not to maximize profit but to provide cost-based financial products and services to its members. As of Aug. 31, 2024, the company had a modest geographic concentration in Texas, which represented about 8% of borrowers. Net loan exposure to Texas-based borrowers (excluding loans covered under its standby purchase commitment agreement with Farmer Mac) totaled $5.9 billion and accounted for approximately 17% of total loans outstanding.

Capital And Earnings: Adequately Capitalized With RAC Ratio To Remain 7%-10%

We view CFC as adequately capitalized on a risk-adjusted basis, as reflected in a RAC ratio of 9.3% as of Aug. 31, 2024, which is within our expected range of 7%-10%. We adjust CFC's adjusted common equity (ACE) for the prior-year cumulative derivative forward-value adjustment and current year-to-date derivative forward-value gains or losses, which totaled gains of $378 million as of Aug. 31, 2024. This is down from gains of $505 million as of the same date last year due to the expected decline in interest rates.

These adjustments are related to interest-rate swaps that CFC uses to hedge interest-rate risk related to differences in the repricing characteristics of its loan portfolio and its borrowings. Those hedges create some timing asymmetry in the company's financial reporting under generally accepted accounting principles.

Although CFC has not sought the hedge accounting treatment necessary to have its interest-rate swaps classified as cash flow hedges for financial reporting, we believe these hedges are economically effective. Therefore, we adjust reported equity in the same manner we do for cash-flow hedges. With interest rates expected to decline in 2025, we could see the forward-value adjustments convert to losses. If that happens, we would add back such losses to ACE.

We treat CFC's subordinated deferrable debt and member capital securities as having intermediate equity content, meaning we would include them at par amount in total adjusted capital (TAC) up to 33% of ACE. The company's ACE was about $2.4 billion as of Aug. 31, 2024. It also had about $947 million of hybrid securities with intermediate equity content, which is more than the $800 million of hybrid securities with intermediate equity content that can be included in TAC.

One of the conditions required to maintain intermediate equity content for hybrid instruments is to have residual time until effective maturity exceeding 20 years. In April 2023, we changed our treatment of the $300 million of subordinated deferrable debt due April 2043 to fully debt (no equity content). The treatment change had no impact on our RAC ratio. Similarly, we will change our treatment of the $350 million of subordinated deferrable debt due April 2046 to fully debt (no equity content) in April 2026.

The company's business model has historically generated relatively modest--yet stable--earnings. It aims to provide members with attractively priced loans and allows them to benefit from CFC's relatively low-cost funding. The company's interest-earning assets had an average yield of 4.64% and the adjusted net interest yield was 1.11% for the fiscal year ended May 31, 2024. For the quarter ended Aug. 31, 2024, the interest-earning assets average yield was 4.69% and adjusted net interest yield was 1.05%.

CFC expects the yield curve to further steepen throughout the remainder of 2024 and in 2025. The company projects increases in reported net interest income and net interest yield over the next 12 months compared with the 12 months ended Aug. 31, 2024. At the same time, the company expects its adjusted debt-to-equity ratio will stay slightly above 6.32x (the ratio as of Aug. 31, 2024) due to increasing total debt outstanding to fund anticipated loan growth.

CFC also reports an adjusted times interest earned ratio (adjusted TIER), a measure of its ability to cover interest expense. Adjusted to include derivative cash settlements in interest expense and exclude derivative fair value from net income, it is essentially a ratio of adjusted net income plus adjusted interest expense over adjusted interest expense.

The company targets a minimum annual adjusted TIER of 1.10x. Under a covenant on the company's revolving credit lines, an average ratio over a six-quarter period cannot drop below 1.025x. For the fiscal year ended May 31, 2024, the company's adjusted TIER was 1.24x, and it was 1.20x for the quarter ended Aug. 31, 2024. Based on current yield curve assumptions, we think this ratio could decline slightly over the next 12 months but will remain above the covenant requirement.

Risk Position: Low Credit Risk In Electric Utility Loan Portfolio, Notwithstanding Some Large Single-Borrower Exposures

CFC has a low-risk loan portfolio, strong asset quality metrics, and prudent risk management policies, in our view. We believe its loans to electric utilities have a low risk of default, which is reflected in the modest charge-offs the company historically reported on its mostly senior secured loans.

During its 55-year history, CFC has only had cumulative net charge-offs of $100 million in its electric utility loan portfolio. The company has reduced its exposure to telecommunications loans, which historically had weaker credit performance, to $611 million as of Aug. 31, 2024, from $2.99 billion as of the end of fiscal 2005.

Prior to the bankruptcy filings by Brazos Electric Power Cooperative (Brazos) in March 2021 and Brazos Sandy Creek in March 2022, CFC did not experience any defaults or charge-offs in its electric utility and telecom loan portfolios since fiscal years 2013 and 2017, respectively. The company had one nonperforming loan of $49 million as of Aug. 31, 2024, representing 0.14% of total loans outstanding. This is a slight decrease from 0.26% as of Aug. 31, 2023, driven by the receipts of $36 million in payments on the nonperforming loan.

Despite CFC's low historical loss experience, borrower concentration remains a risk, in our view. CFC's 20 largest borrowers accounted for 20% of its loans outstanding (19% net of loans covered under its standby purchase commitment agreement with Farmer Mac) as of Aug. 31, 2024. The risk assessment also considers how a low-probability event could affect rural electric utility cooperatives, such as the Texas polar vortex in February 2021 that affected two of CFC's borrowers (Brazos and Rayburn Country Electric Cooperative).

Positively, CFC's senior secured positions help mitigate any expected losses in the event of a borrower defaulting. While the Texas polar vortex in February 2021 affected two borrowers, the company's losses in the event were relatively low at about $14 million. In addition, we do not expect CFC's credit quality to be materially affected by the frequent hurricanes in some states in which the company operates, because electric cooperatives would most likely be reimbursed by the Federal Emergency Management Agency relief programs for eligible storm-related damages.

Funding And Liquidity: Stable Funding Sources And Adequate Liquidity

We believe CFC has adequate funding and liquidity, given its access to a variety of stable funding sources. As of Aug. 31, 2024, CFC had $32 billion of debt outstanding, excluding subordinated deferrable debt and member capital securities. The Federal Financing Bank and Farmer Mac provided CFC with 30% of its total debt outstanding as of Aug. 31, 2024, offering a source of relatively low-cost, long-term financing to help fund rural utility lending. The company also has a long history of accessing the broader debt capital markets, which represent about 55% of its total debt outstanding.

CFC's members account for 15% of its borrowings, including members' subordinated securities. CFC's member subordinated certificates are subordinated to all other debt issues, including nonmember subordinated securities, providing additional cushion to senior creditors. Members' subordinated certificates consist of membership subordinated certificates ($629 million), loan and guarantee subordinated certificates ($322 million), and member capital securities ($246 million).

CFC's stable funding ratio was 86% as of Aug. 31, 2024, reflecting some usage of commercial paper and other short-term borrowings. We would view increased usage and reliance on short-term borrowings as a weakness; however, CFC currently has a very diverse capital structure with numerous counterparties, including its members.

We expect CFC to maintain adequate liquidity to meet its unadvanced loan commitments. As of Aug. 31, 2024, CFC's total unadvanced commitments were approximately $10 billion in line of credit loans and $6.8 billion in long-term loans. Typically, the utilization rate for line of credit loans is relatively low, but borrowers generally draw on the majority of long-term loan commitments over a period of several years.

As of Aug. 31, 2024, the company had $2.5 billion in availability with Farmer Mac, $1.2 billion under the Guaranteed Underwriter Program from the Federal Financing Bank, and $265 million in unrestricted cash and equivalents. It also had access to $2.8 billion in unsecured revolving credit facilities with a group of banks, as well as a liquid fixed-income investment portfolio of $231 million.

Other Credit Considerations

We apply a positive comparable ratings adjustment to CFC to reflect its funding advantage relative to other finance companies through its arrangements with the Federal Financing Bank and Farmer Mac. The adjustment also reflects the company's borrowings from its members, which provide additional cushion to senior creditors.

Environmental, Social, And Governance

Environmental, social, and governance factors are an overall neutral consideration in our credit rating analysis of CFC. We believe there is low credit risk in CFC's electric utility loan portfolio, but it has some large single-borrower exposures, and the February 2021 polar vortex showed that a low-probability event could affect more than one of its borrowers.

Ratings Score Snapshot

Issuer credit rating: A-/Stable/A-2

Stand-alone credit profile: a-

- Preliminary anchor: bb+
- Entity-specific adjustment: +1
- Business position: Very strong (+2)
- Capital and earnings: Adequate (0)
- Risk position: Adequate (0)
- Funding and liquidity: Adequate and adequate (0)
- Comparable rating analysis: Positive (+1)

Support: 0

- GRE support: 0
- Group support: 0
- Sovereign support: 0

Additional factors: 0

Key Statistics

Table 1

CFC Business position

(Mil. $)	August 2024	May 2024	2023	2022	2021
Total assets	36,488	36,178	34,012	31,251	29,638
Gross receivables	35,111	34,542	32,532	30,063	28,427
Net income after extraordinaries	(164)	553	501	796	812
Net interest margin (%)	0.70	0.75	0.99	1.46	1.48

Table 2

CFC Capital and earnings

	August 2024	May 2024	2023	2022	2021
S&P Global Ratings' RAC ratio before diversification (%)	9.3	9.2	9.1	9.0	8.5
Adjusted common equity/total adjusted capital (%)	75.2	75.2	75.2	75.2	75.2
Core earnings/average managed assets (%)	N/A	0.83	0.76	0.79	0.67

RAC--Risk-adjusted capital.

Table 3

CFC Risk position

	August 2024	May 2024	2023	2022	2021
Growth in gross receivables (%; YoY)	6.09	6.18	8.21	5.76	6.46
Nonperforming assets/receivables + other real estate owned (%)	0.14	0.14	0.37	0.79	0.87
Net charge-offs/average gross receivables (%)	0	(0.00)	0.05	0	0
New loan loss provisions/average gross receivables (%)	0.01	(0.02)	0.00	(0.06)	0.10
Loan loss reserves/gross receivables (%)	0.14	0.14	0.16	0.22	0.30
Loan loss reserves/gross nonperforming assets (%)	102.1	100.1	44.1	28.5	34.6

YoY--Year on year.

Table 4

CFC Funding and liquidity

	August 2024	May 2024	2023	2022	2021
Stable funding ratio (%)	86.3	87.3	85.7	82.7	81.7
Liquidity coverage metric (x)	0.72	0.74	0.67	0.61	0.72

Table 5

CFC Total adjusted capital

(Mil. $)	August 2024	May 2024	2023	2022	2021
Common shareholders' equity	2,781	2,991	2,562	2,115	1,375
Plus: minority interest (equity)	20	21	27	27	25
Less: revaluation reserves	(1)	(1)	8	2	(0)
Less: other adjustments	378	608	343	91	(467)
Intermediate adjusted common equity	2,424	2,406	2,238	2,049	1,867

Table 5

CFC Total adjusted capital (cont.)

(Mil. $)	August 2024	May 2024	2023	2022	2021
Less: DTA arising from temporary differences not convertible into cash or government bonds exceeding 10% of intermediate ACE	0	0	0	0	0
Adjusted common equity	2,424	2,406	2,238	2,049	1,867
Plus: admissible preferred and hybrids	800	794	738	676	616
Total adjusted capital	3,224	3,199	2,976	2,725	2,483

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings Detail (As Of November 14, 2024)*	
National Rural Utilities Cooperative Finance Corp.	
Issuer Credit Rating	A-/Stable/A-2
Senior Secured	A-
Senior Unsecured	A-
Short-Term Debt	A-2
Subordinated	BBB
Issuer Credit Ratings History	
06-Aug-2021	A-/Stable/A-2
05-Mar-2021	A-/Negative/A-2
12-Apr-2016	A/Stable/A-1
Sovereign Rating	
United States	AA+/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.