MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms National Rural Utilities ratings; outlook is stable

28 Nov 2018

Approximately $12.9 billion of debt securities affected

New York, November 28, 2018 -- Moody's Investors Service ("Moody's") affirmed all of National Rural Utilities Cooperative Finance Corporation's (CFC) ratings. Ratings affirmed include CFC's senior secured collateral trust bonds and notes at A1, CFC's senior unsecured debt at A2, CFC's subordinate debt at A3, the shelf registrations for CFC's senior secured debt and senior unsecured debt at (P)A1 and (P)A2, respectively, and CFC's Prime-1 short-term rating for commercial paper. Additionally, Moody's affirmed the A2, VMIG-1, and P-1 ratings assigned to CFC guaranteed tax-exempt debt issued by municipal entities for the benefit of individual member electric cooperatives. CFC's rating outlook remains stable.

Outlook Actions:

..Issuer: National Rural Utilities Coop. Finance Corp.

....Outlook, Remains Stable

Affirmations:

..Issuer: Atascosa Co. Industrial Devel. Corp., TX

....Senior Unsecured Revenue Bonds, Affirmed A2

....Senior Unsecured Revenue Bonds, Affirmed VMIG 1

..Issuer: Chatom (Town of) AL, Ind. Dev. Board

....Senior Secured Revenue Bonds, Affirmed A2

....Senior Secured Revenue Bonds, Affirmed VMIG 1

..Issuer: Cochise (Cnty of) AZ, Pollution Control Corp.

....Senior Secured Revenue Bonds, Affirmed A2

..Issuer: National Rural Utilities Coop. Finance Corp.

....Senior Unsecured Shelf, Affirmed (P)A2

....Subordinate Regular Bond/Debenture, Affirmed A3 (hyb)

....Senior Secured Regular Bond/Debenture, Affirmed A1

....Senior Secured Shelf, Affirmed (P)A1

....Senior Unsecured Commercial Paper, Affirmed P-1

....Senior Unsecured Medium-Term Note Program, Affirmed (P)A2

....Senior Unsecured Regular Bond/Debenture, Affirmed A2

..Issuer: Public Finance Authority

....Senior Unsecured Revenue Bonds, Affirmed A2

..Issuer: PULASKI (COUNTY OF) KY

....Senior Unsecured Revenue Bonds, Affirmed A2

....Senior Unsecured Revenue Bonds, Affirmed VMIG 1

..Issuer: York (County of) SC

....Senior Unsecured Revenue Bonds, Affirmed A2

....Senior Unsecured Revenue Bonds, Affirmed P-1

RATINGS RATIONALE

The rating affirmations reflect the high quality of CFC's loan portfolio, its unique market position as the dominant lender to electric cooperatives, an ability to continue producing margins at or above its targeted 1.1x adjusted times interest earned ratio (TIER), a good track record of managing credit restructurings, a sound risk management program, and significantly reduced exposure to the more volatile telecommunications sector. "A core element of CFC's credit strength is the durability of its loan portfolio as the dominant secured lender to electric cooperatives", said Vice President-Senior Analyst, Kevin Rose. "This sector is low risk and capable of producing highly predictable cash flows due to most cooperatives' monopoly position as well as the cooperatives' ability to pass along most cost increases to their electric customers when needed, without the approval of state regulators", Rose added. Loans to electric distribution cooperatives represent 78% of CFC's loan portfolio at August 31, 2018 and loans to rural electric cooperatives (RECs) and entities owned, operated and controlled by RECs represent approximately 98% of the total portfolio. Adding to the strength of CFC's loan portfolio is the fact that over 90% of its loans are secured, which together with the portfolio's low historic default rate, result in a loan portfolio that has historically produced very modest net loan losses.

The affirmations also acknowledge CFC's steadfast commitment to minimize lending to the riskier telecommunications sector, a credit positive strategy. The total outstanding telecommunications loans have declined by well over $4.0 billion since fiscal 2003 with about $358.6 million outstanding as of August 31, 2018, representing just 1% of CFC's total outstanding loan portfolio.

The rating affirmations factor in the credit benefits of CFC's unique role as a tax-exempt cooperative providing a supplemental source of low-cost capital to its cooperative membership. Unlike other finance companies, CFC is a cost-plus lender with a business model that tends to exhibit an overall lower credit risk profile as its success is not determined by achieving earnings targets, balance sheet expansion, or profitability objectives.

Balancing these factors is the concentration risk that remains within CFC's operations as well as its degree of single obligor risk within the loan portfolio. While CFC has made substantial headway to address single obligor risk, particularly within its telecommunications portfolio, such risk is likely to remain a characteristic of the CFC lending platform. The rating also considers Moody's assessment of the average credit quality of CFC's electric cooperative member base, with many of its unrated borrowers exhibiting single A credit characteristics.

Due to the nature of its ownership structure, CFC does not have common stock in its capital structure and therefore must fund incremental loan growth with debt. In place of common equity, Moody's views the deeply subordinated capital term certificates as having equity like characteristics. CFC's Moody's adjusted leverage has crept up in recent periods to fund loan growth; however management remains committed to reducing leverage over time. At August 31, 2018, the CFC ratio of adjusted funded debt to adjusted members' equity, including Moody's adjustments, was 7.83x, which is above the range of 7.04-7.22x achieved during fiscal years 2010-2014 and higher than the average metric of 7.45x from 2014-2018. The current leverage ratio is comparable to the 7.83x exhibited nine years ago.

Although CFC continues to rely on wholesale funding as a source of capital, the firm's credit quality benefits from its success in reducing reliance on this type of funding. In CFC's case, the member cooperatives are providing approximately 19% of its total debt funding, and access to private financing exists from the Federal Financing Bank (FFB) of the US Treasury under the Guaranteed Underwriter Program (GUP) and from the Federal Agricultural Mortgage Corporation (Farmer Mac). Together, both arrangements have provided CFC with long-term funding exceeding $7 billion as of August 31, 2018, which Moody's views favorably from a credit perspective. Also, as of August 31, 2018, CFC had about $3,947 million of remaining funding capability in aggregate under the two programs, which provides an above average liquidity profile. Even including these diversified funding sources, CFC still has dependence on wholesale short-term and long-term funding. CFC's primary sources of long-term capital market funding include secured collateral trust bonds (CTBs), unsecured medium term notes (MTNs) and InterNotes, and subordinated deferrable debt, with proceeds used in most years to principally meet maturing debt obligations. In most years, CFC's amortizing loan portfolio provides $1 billion or more of cash flow to the cooperative.

The affirmation of CFC's short term ratings reflects the firm's above average liquidity profile as it maintains various committed bank facilities which Moody's considers to be the firm's principal form of external liquidity support. These arrangements supplement $266 million of cash and cash equivalents and $554 million of liquid, short- to intermediate-term held to maturity investment grade debt securities as of August 31, 2018 and about $1.31 billion of scheduled loan amortizations and repayments over the next 12 months. CFC also has about $4.675 billion available under the arrangements with FFB and Farmer Mac, including CFC's November closing on a previously approved $750 million additional commitment under the GUP. Through an amendment and extension process closed on November 28, 2018, CFC has two committed credit facilities aggregating $2,975 million. Specifically, CFC has a $1,440 million facility with a November 2021 expiration date and a $1,535 million facility with a November 2023 expiration date. This process modestly reduces available liquidity by $110 million. With these facilities in place, the total amount of commercial paper that can be issued by CFC is capped at $2,975 million. These credit facilities do not contain a MAC clause but have financial covenants which are set at levels that provide substantial cushion.

Rating Outlook

The stable rating outlook incorporates our view that any loan growth among RECs will help maintain strong asset quality within the loan portfolio, particularly as the telecommunications loan portfolio remains a non-material portion of the total loan portfolio. The stable outlook also considers CFC's commitment to gradually reduce leverage, while maintaining a good liquidity profile and expanded access to private sources of funding to offset the firm's reliance on wholesale funding. CFC's high leverage, single industry concentration and single obligor concentration remain rating constraints.

What Could Change the Rating -- Up

CFC's relatively high leverage, which has modestly increased in recent periods after several years of improvement, as well as its single industry and single-obligor concentration collectively limit the prospect of a rating upgrade within the next 12 months.

Prospects for a positive rating action exist beyond the next 12 months if the Moody's adjusted debt to adjusted capital funds metric improves to be well under 7.0x on a sustained basis, liquidity remains strong, and alternatives to wholesale capital market funding increase in number and depth, while CFC continues to maintain a relatively clean portfolio with no new large non-performing assets; this is particularly the case if the CFC loan portfolio can continue to demonstrate an ability to produce stable financial results which exceed the 1.1x adjusted times interest earned ratio (TIER) target on a consistent basis.

What Could Change the Rating -- Down

A negative rating action could result if one or more new large problem loans surfaced within CFC's portfolio, if the lending strategy began to focus on growing its lending to non-core electric cooperative markets, if ongoing debt capital raising efforts and capital rotation policies materially increase CFC's leverage, if access to private sources of long-term capital become constrained or if CFC fails to maintain an adequate liquidity profile, including ample access to multi-year bank credit facilities.

Headquartered in Dulles, Virginia, CFC is a private, tax-exempt cooperative association exclusively serving rural electric and telecommunication utilities. The principal purpose of CFC is to provide its members with a source of financing to supplement the loan programs of the Rural Utilities Service of the US Department of Agriculture. At August 31, 2018, CFC had total assets of approximately $26.68 billion, of which loans to members represented about $25.18 billion. At August 31, 2018, approximately 99% of CFC's total loan portfolio was with RECs and entities owned, operated and controlled by RECs.

The principal methodology used in these ratings was the Finance Companies published in December 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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