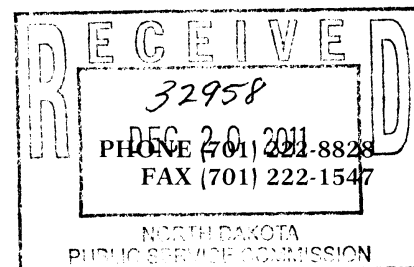


PATRICIA E. CLEMENT
Treasurer and Assistant Secretary



December 16, 2011

Mr. James Deutsch, Director
Reclamation Division
Public Service Commission
600 E. Boulevard Ave. Dept. 408
Bismarck, ND 58505-0480

RE: CB 9702-03 CoBank ACB Letter of Credit

Dear Mr. Deutsch:

BNI is submitting documentation verifying the placement of a Letter of Credit number 00615768 issued by CoBank on December 15, 2010 for Permit BNCR9702, 8602, 8202, and 8106. This Letter of Credit is set to expire one year after the original date.

Letter of Credit 00615768

- Collateral Bond Agreement (Letter of Credit)
- CoBank ACB Letter of Credit
- CoBank ACB 2010 Annual Report
- CoBank ACB Resolution of Authorized Officers
- Description of acreage (See Attachment 1 9,226.29 acres)
- Map of acreage (See Map-Attachment 2 9,226.29 acres)
- Description/Map- Federal Acres (See Map/Description-Attachment 3 & 4 1598.08 acres)

Please advise if you need additional information.

Best regards,

Patricia E. Clement

Enclosure

1 RC-11-714 Filed 12/19/2011 Pages: 215
Collateral bond documents with a letter of credit
BNI Coal, Ltd.
Patricia Clement



COLLATERAL BOND AGREEMENT (LETTER OF CREDIT)
 PUBLIC SERVICE COMMISSION
 RECLAMATION DIVISION
 SFN 54012 (3-2004)

| | |
|--|-------------------------------------|
| Permittee BNI Coal, Ltd. | |
| Permit Number BNCR 9702, 8602, 8202, 8106 | Collateral Bond Number CB9702-03 |

The above named Permittee is the holder of the Surface Coal Mining and Reclamation Operations Permit listed above and is duly authorized to do business in the State of North Dakota. Permittee, AS PRINCIPAL, is held firmly bound unto the State of North Dakota, in the sum of Two thousand six hundred and twenty five thousand Dollars (\$ 2,625,000.00), lawful money of the United States of America to be paid to the State of North Dakota upon order of forfeiture by the North Dakota Public Service Commission (NDPSC), for the payment of which we hereby jointly and severally bind ourselves, our heirs, executors, administrators, successors, and assigns.

Contemporaneously with execution and delivery of this Collateral Bond, the Permittee gives the NDPSC Irrevocable Standby Letter of Credit Number 00615768 issued by CoBank, ACB in the amount of \$ 2,625,000.00, (collateral) attached as Exhibit 1.

This agreement covers any and all land affected or to be affected by surface coal mining and reclamation operations within the bond area containing 9226.29 acres and as described in attached Exhibit 2 (legal description) and Exhibit 3 (map). This agreement covers all mining related disturbances since the issue date of the Permit.

To the extent that there are any Federal lands containing leased Federal coal or Federal lands that were leased and mined within the bond area, this Collateral Bond is also payable to the United States/Office of Surface Mining Reclamation and Enforcement (OSMRE). As required by the Cooperative Agreement between the State of North Dakota and the United States Department of the Interior, both NDPSC and OSMRE are co-obligees under this Collateral Bond and the NDPSC must obtain OSMRE concurrence prior to releasing any obligation under this Collateral Bond for Federal lands containing Federal coal that will be or was mined. The bond area described in Exhibits 2 and 3 contains 1598.08 acres of Federal lands containing leased Federal coal that is or was leased. These Federal lands are described in attached Exhibit 4 (legal description) and Exhibit 5 (map). To the extent these Federal lands are involved, release of this Collateral Bond also is conditioned upon compliance with applicable Federal laws and regulations and the provisions of the Cooperative Agreement between the State of North Dakota and the United States Department of the Interior at 30 C.F.R. 934.30. If the Cooperative Agreement at 30 C.F.R. 934.30 is terminated, this Collateral Bond shall continue in effect and, to the extent these Federal lands are involved, the bond shall be payable to the United States.

This agreement shall remain in full force and effect until either released or forfeited under North Dakota Century Code Chapter 38-14.1 and North Dakota Administrative Code Article 69-05.2.

Permittee agrees that this obligation is non-cancellable and that the liability hereunder is for the duration of the surface coal mining and reclamation operations, and continues thereafter for a period coincident with the Permittee's responsibility for the establishment of vegetation on the affected areas pursuant to the requirements of North Dakota Century Code Chapter 38-14.1 and North Dakota Administrative Code Article 69-05.2, EXCEPT THAT the obligation may be reduced if approved by NDPSC or replaced if a substitute bond acceptable to the NDPSC has been submitted.

If Permittee complies with the terms and conditions of the permit and the provisions of North Dakota Century Code Chapter 38-14.1 and North Dakota Administrative Code Article 69-05.2, then the release of this obligation shall proceed as specified in the law and rules.

Permittee further agrees that this Collateral Bond is posted to insure the Permittee's performance upon all acres contained in the permit. Upon bond forfeiture, any bond which continues to be held by the NDPSC for the Permit may be forfeited for use by the NDPSC to complete the reclamation plan for the acres in the Permit and to cover associated administrative expenses.

Collateral Bond Number
CB9702-03

Permittee further agrees and understands that this Collateral Bond remains in force and effect unless reduced or replaced in accordance with North Dakota Century Code Chapter 38-14.1 and North Dakota Administrative Code Article 69-05.2.

This Collateral Bond may be executed in any number of identical counterparts, each of which, when executed and delivered by the parties hereto, shall be considered to be an original, but all of which shall collectively constitute one and the same instrument.

In witness whereof, we, the said parties, have set our hands and seals.

Effective December 16, 2011. (Date)

PERMITTEE

| | |
|---|--------------------------|
| Signature of President or Authorized Officer <i>Wade W. Boeshans</i> | |
| Name Wade W. Boeshans | Title General Manager |

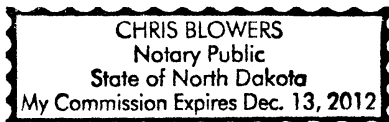
| | |
|--|------------------------------|
| Signature of President or Authorized Officer <i>Patricia E. Clement</i> | |
| Name Patricia E. Clement | Title Treas. & Ass't Sec. |

ACKNOWLEDGMENT OF PERMITTEE

State of North Dakota)
)SS.
County of Burleigh)

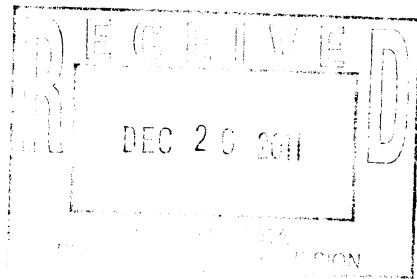
The foregoing instrument was acknowledged before me on this date December 16, 2011 by Wade W. Boeshans and Patricia E. Clement of BNI Coal, Ltd., a North Dakota corporation, on behalf of the corporation.

(S E A L)



BY: Chris Blowers
NOTARY PUBLIC

MY COMMISSION EXPIRES: Dec 13, 2012



IRREVOCABLE STANDBY LETTER OF CREDIT NO. 00615768

ISSUE DATE: DECEMBER 15, 2011
EXPIRATION DATE: DECEMBER 15, 2012
AMOUNT: \$2,625,000.00

BENEFICIARY:

PUBLIC SERVICE COMMISSION
STATE OF NORTH DAKOTA
600 EAST BOULEVARD AVE., DEPT. 408
BISMARCK, ND 58505-0480

ISSUING BANK:

COBANK, ACB
5500 SOUTH QUEBEC STREET
GREENWOOD VILLAGE, CO 80111

SURFACE COAL MINING PERMIT NUMBER: BNCR 9702, 8602, 8202 and 8106

COLLATERAL BOND NUMBER: CB9702-03

COMMISSIONERS:

ON BEHALF OF BNI COAL, LTD, 1637 BURNT BOAT DRIVE, BISMARCK, ND 58502-0897, WE HEREBY ESTABLISH OUR IRREVOCABLE STANDBY LETTER OF CREDIT IN YOUR FAVOR, ENTITLING THE NORTH DAKOTA PUBLIC SERVICE COMMISSION (COMMISSION) TO DRAW ON THIS LETTER OF CREDIT IN PART OR IN FULL, AVAILABLE BY YOUR DRAFT(S) IN AN AMOUNT NOT TO EXCEED TWO MILLION SIX HUNDRED TWENTY FIVE THOUSAND DOLLARS (\$2,625,000.00) ACCOMPANIED BY A WRITTEN DEMAND BY THE COMMISSION PURSUANT TO NORTH DAKOTA ADMINISTRATIVE CODE (NDAC) 69-05.2-12-04.

THIS LETTER OF CREDIT IS EFFECTIVE DECEMBER 15, 2011, AND WILL EXPIRE AT THE CLOSE OF BUSINESS ON DECEMBER 15, 2012, AND IS IRREVOCABLE FOR A TERM OF AT LEAST ONE YEAR. THIS LETTER OF CREDIT IS AUTOMATICALLY RENEWABLE WITHOUT AMENDMENTS FOR ADDITIONAL ONE YEAR TERMS UNLESS WE GIVE AT LEAST NINETY (90) DAYS NOTICE IN WRITING BY CERTIFIED MAIL, RETURN RECEIPT REQUESTED, TO THE COMMISSION AND THE PERMITTEE OF THE BANK'S INTENT TO TERMINATE THE LETTER OF CREDIT AT THE END OF THE CURRENT TERM.

EXCEPT WHEN THE AMOUNT OF THE LETTER OF CREDIT IS INCREASED, THE CREDIT CANNOT BE MODIFIED OR REVOKED WITHOUT THE CONSENT OF THE COMMISSION.

THE COMMISSION MAY DRAW ON US AT SIGHT WITHIN THIRTY (30) DAYS OF SUCH NOTICE TO THE COMMISSION OF OUR INTENT TO TERMINATE THE CREDIT, ACCOMPANIED BY A STATEMENT SIGNED BY AN AUTHORIZED REPRESENTATIVE OF THE COMMISSION CERTIFYING THAT THE AMOUNT OF THE DRAWING REPRESENTS FUNDS DUE TO THE COMMISSION BECAUSE THE PERMITTEE HAS FAILED TO REPLACE THIS LETTER OF CREDIT BY OTHER SUITABLE BOND OR LETTER OF CREDIT PURSUANT TO NDAC 69-05,2-12-04; AND THE COMMISSION MAY DRAW ON US AT SIGHT IN PART OR IN FULL ACCOMPANIED BY A STATEMENT SIGNED BY AN AUTHORIZED REPRESENTATIVE OF THE COMMISSION CERTIFYING THAT THE AMOUNT OF THE DRAWING REPRESENTS FUNDS DUE TO THE COMMISSION BECAUSE OF A NOTICE OF FORFEITURE ISSUED





IRREVOCABLE STANDBY LETTER OF CREDIT NO. 00615768

BY THE COMMISSION TO THE PERMITTEE IN ACCORDANCE WITH NDAC 69-05.2-12-16 AND 69-5.2-12-18.

DRAFTS DRAWN HEREUNDER MUST BE MARKED "DRAWN UNDER COBANK, ACB LETTER OF CREDIT NO. 00615768 DATED DECEMBER 15, 2011 ACCOMPANIED BY A STATEMENT SIGNED BY AN AUTHORIZED REPRESENTATIVE OF THE COMMISSION READING AS FOLLOWS:

"AT SIGHT, PAY TO THE ORDER OF THE NORTH DAKOTA PUBLIC SERVICE COMMISSION, THE AMOUNT OF (DRAWING AMOUNT) DOLLARS (\$AMOUNT IN NUMBERS). I CERTIFY THE NORTH DAKOTA PUBLIC SERVICE COMMISSION IS MAKING THIS DRAWING AMOUNT PURSUANT TO THE TERMS OF IRREVOCABLE STANDBY LETTER OF CREDIT NO. 00615768 DATED DECEMBER 15, 2011 AND ISSUED BY COBANK ACB AND THE ASSOCIATED COLLATERAL BOND AGREEMENT BETWEEN THE APPLICANT BNI COAL, LTD AND THE COMMISSION AND THAT THE COMMISSION IS ENTITLED TO THE AMOUNT OF THIS DRAW."

WE CERTIFY THAT THE AMOUNT OF THE CREDIT HEREIN ESTABLISHED WILL NOT BE REDUCED FOR ANY REASON DURING THE PERIOD OF THIS INSTRUMENT WITHOUT THE WRITTEN CONSENT OF THE COMMISSION.

WE WILL GIVE PROMPT NOTICE TO THE COMMISSION AND PERMITTEE OF ANY NOTICE RECEIVED OR ACTION FILED ALLEGING THE INSOLVENCY OR BANKRUPTCY OF THE BANK, OR ALLEGING ANY VIOLATIONS OF REGULATORY REQUIREMENTS WHICH COULD RESULT IN SUSPENSION OR REVOCATION OF THE BANK'S CHARTER OR LICENSE TO DO BUSINESS. IN THE EVENT OF ACTIONS WHICH COULD RESULT IN SUSPENSION OR REVOCATION OF THE BANK'S CHARTER OR LICENSE, THE COMMISSION HAS THE RIGHT TO DRAW UPON THE LETTER OF CREDIT BEFORE THE END OF ITS TERM AND CONVERT IT INTO A CASH COLLATERAL BOND IF THE PERMITTEE FAILS TO REPLACE THE LETTER OF CREDIT WITH A SUBSTITUTE BOND WITHIN THIRTY (30) DAYS AFTER RECEIPT OF SUCH A NOTICE FROM THE COMMISSION. IN THE EVENT THE BANK BECOMES UNABLE TO FULFILL ITS OBLIGATIONS UNDER THIS LETTER OF CREDIT FOR ANY REASON, NOTICE SHALL BE GIVEN IMMEDIATELY TO THE COMMISSION AND PERMITTEE.

ATTACHED IS A COPY OF THE BANK'S MOST RECENT BALANCE SHEET, CERTIFIED BY A CERTIFIED PUBLIC ACCOUNTANT. WE COMMIT TO SUBMITTING ANNUAL BALANCE SHEETS TO THE COMMISSION WITHIN NINETY (90) DAYS AFTER THE CLOSE OF THE BANK'S FISCAL YEAR.

THE LAWS OF THE STATE OF NORTH DAKOTA GOVERN THIS LETTER OF CREDIT. THE COURTS OF THE STATE OF NORTH DAKOTA WILL BE USED TO RESOLVE ANY DISPUTE REGARDING THIS LETTER OF CREDIT.

THIS LETTER OF CREDIT IS SUBJECT TO THE CURRENT VERSION OF THE UNIFORM CUSTOMS AND PRACTICES FOR DOCUMENTARY CREDITS, PUBLISHED BY THE INTERNATIONAL CHAMBER OF COMMERCE, AND THE NON-VARIABLE PROVISIONS OF SUBSECTION 3 OF NORTH DAKOTA CENTURY CODE SECTION 41-05-16.

WE HEREBY AGREE WITH THE COMMISSION THAT ANY DRAFTS DRAWN UNDER AND IN COMPLIANCE WITH THE TERMS OF THIS LETTER OF CREDIT WILL BE DULY HONORED IF PRESENTED TO US AT THE OFFICE LOCATED AT 5500 SOUTH QUEBEC STREET, GREENWOOD





IRREVOCABLE STANDBY LETTER OF CREDIT NO. 00615768

VILLAGE, CO 80111. ON OR BEFORE THE STATED EXPIRATION DATE OR ON OR BEFORE THE EXPIRATION DATE OF ANY RENEWAL PERIOD.

DATE: DECEMBER 15, 2011



Linda J. Law
(SIGNATURE)

Linda J. Law, Director
(PRINTED NAME AND TITLE)*

Holly J. Womack
(SIGNATURE)

Holly Womack, Vice President
(PRINTED NAME AND TITLE)

*BANK PRESIDENT AND TREASURER OR CASHIER OR OTHER OFFICERS AUTHORIZED TO EXECUTE LETTERS OF CREDIT (INCLUDE CORPORATE SECRETARY'S CERTIFICATE THAT REFERS TO THE BY-LAWS OR BOARD RESOLUTION AUTHORIZING OFFICERS TO EXECUTE LETTERS OF CREDIT)





IRREVOCABLE STANDBY LETTER OF CREDIT NO. 00615768

ACKNOWLEDGEMENT OF BANK

STATE OF COLORADO
COUNTY OF ARAPAHOE

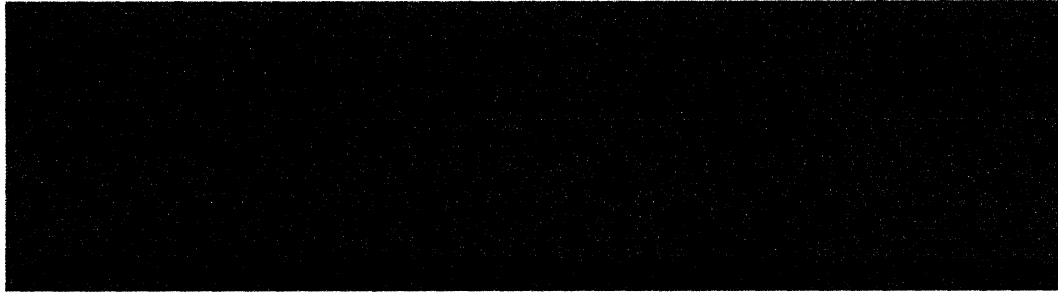
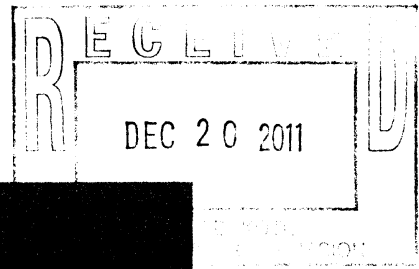
On this 15TH day of December 2011, before me personally appeared Linda J. Law and Holly J. Womack, known to me to the Director and Vice President of the Bank that is described in and that executed within instrument, and acknowledged to me that the corporation executed the same.

SEAL

S. Lawrence Lyle
(Notary Public)

My Commission expires 10/10/15





List of Authorized Signatures



May 2010



Resolution of Signatory Authority

WHEREAS, Article V of the Bylaws of CoBank, ACB, provides that all checks, drafts, and other orders for the payment of money, all notes and other evidences of indebtedness; all certificates of stock; all deeds, conveyances, endorsements, assignments, and other instruments of transfer; and all contracts, agreements, and other instruments and writings, shall be signed, executed, and delivered by such officers, agents, or employees of the bank, and in such a manner as may from time to time be authorized by the board;

NOW, THEREFORE, BE IT RESOLVED, that effective July 1, 2006, all signatory authority heretofore granted to employees of the bank is rescinded, and the following signatory authority is given under the aforesaid Article V of the Bylaws.

1. Checks, drafts, and other orders for the payment of money in an amount less than \$50,000 shall be signed by any one of the following:
 - (A) President and Chief Executive Officer
 - (B) Executive Vice President/Chief Financial Officer
 - (C) Controller
 - (D) Treasurer
 - (E) or by any employee of the bank named and with a title as designated in writing by the bank's Controller, and approved by the President and Chief Executive Officer or his designee.

Any checks, drafts, and other orders for the payment of money equal to or in excess of \$50,000 must be signed by two of the above authorized individuals, except that any one individual above is authorized to sign checks, drafts, and other orders for the payment of money equal to or in excess of \$50,000 for bank capital plan disbursements, and for processing equipment purchase payments and sales/ property tax payments on behalf of Farm Credit Leasing.

2. Collateral securities shall be assigned or endorsed and delivered by any one of the individuals named in number 1.

-
3. Promissory notes and other evidences of indebtedness shall be signed by two officers of the bank composed of (1) the Treasurer, or the Treasurer's designee, and also (2) by either the President and Chief Executive Officer, any Executive Vice President, any Senior Vice President, any Vice President, the Secretary, or Assistant Secretary; provided, however, that borrowings in the normal course of business which are in the form of Consolidated Systemwide Notes and Bonds, Federal Funds Purchased and Repurchase Agreements, which are typically executed telephonically, may be executed by the Treasurer or the Treasurer's designee as named in a writing containing the designee's title.
 4. Letter of Credit issued by the bank must be signed by any two of the following officers:
 - (A) President and Chief Executive Officer
 - (B) Executive Vice President
 - (C) Senior Vice President
 - (D) Vice President
 - (E) Assistant Vice President
 - (F) Director, Trade Services and L/C Operations
 - (G) Any employee named in writing and with a title as designated by the Executive Vice President and Group Executive International Division
 5. All deeds, conveyances, endorsements, or assignments (other than for collateral security), and other instruments and contracts (except checks, drafts, orders for the payment of money, and promissory notes) shall be signed by the President and Chief Executive Officer, any Executive or Senior Vice President, any Vice President, any Assistant Vice President, the Treasurer, the Secretary, any Assistant Secretary, or by any employee named in writing and with a title as designated by the Senior Vice President Operations Division. Any contract for the purchase of goods and services may be executed by an employee properly designated as Purchasing Agent.
 6. Off-balance sheet financial instrument transactions in the nature of financial futures, forwards, swaps, options, and similar instruments, which are typically executed telephonically, may be executed and approved by the Treasurer or the Treasurer's designee as named in a writing containing the designee's title.

-
7. Investment purchases and sales, which are typically executed telephonically, may be executed and approved by the Treasurer or the Treasurer's designee as named in a writing containing the designee's title.
 8. The board hereby delegates to the President and Chief Executive Officer the authority to further designate signatory authority as circumstances require. Executive Orders shall be used to list the name and title of the person authorized to sign documents and to describe the category of documents covered by the Executive Order.

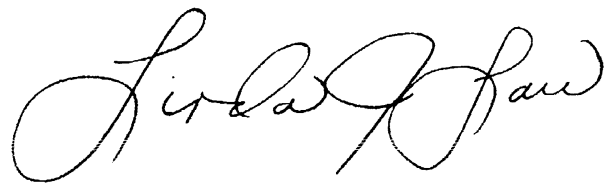
FURTHER RESOLVED, that the officers and employees named in number 1 are severally authorized to order the withdrawal or transfer of funds of this bank on deposit in any commercial bank by means of telegrams, or similar means of communication, such as teletype, telex, etc. prepared with key code words or figures, in such form and with such security arrangements, as may be agreed to between said commercial banks and the bank.

FURTHER RESOLVED, any signatures required pursuant to paragraphs 1 and 5 above may be executed through the use of facsimile signatures under the control of the person authorized to sign.

I, Mark W. Yonkman, Chief Legal and Regulatory Officer of CoBank, ACB, hereby certify that the foregoing is the signatory authority authorized by a resolution adopted by the Board of Directors of CoBank, ACB, on May 10, 2006, with an effective date of July 1, 2006.



Mark W. Yonkman
Chief Legal and Regulatory Officer

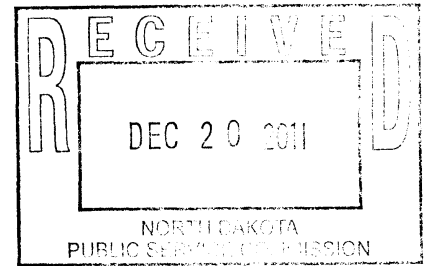
A handwritten signature in black ink, reading "Linda J. Law". The signature is written in a cursive style with large, flowing loops.

Linda J. Law
Director, Trade Services/
Letter of Credit Operations

Holly J. Womack

Holly J. Womack
Vice President

Attachment I
Metes & Bounds Description
Worst Case Bond
BNCR 8106, 8202, 8602 & 9702



Parcels of Land Lying in Townships 141 & 142 North, Ranges 83 & 84 West of the Fifth Principal Meridian, Oliver County, North Dakota, Described As Follows:

Parcel 1

Commencing at the Southeast Corner of Section 31, T. 142 N., R. 83 W.;
(NAD 27-ND State Plane South Zone- US Foot- N: 511,890.2, E: 1,816,747.0);
Thence North 15°46'16" East, a distance of 126.28 feet to the Point of Beginning;
Thence North 00°37'39" East, a distance of 1861.98 feet;
Thence North 68°56'03" West, a distance of 2000.72 feet;
Thence North 49°02'16" West, a distance of 30.79 feet;
Thence South 80°22'30" West, a distance of 1760.46 feet;
Thence North 01°34'15" West, a distance of 205.38 feet;
Thence South 89°59'14" West, a distance of 1728.33 feet;
Thence North 89°24'12" West, a distance of 1574.21 feet;
Thence South 11°20'49" East, a distance of 690.03 feet;
Thence South 78°39'13" West, a distance of 1170.46 feet;
Thence North 11°20'47" West, a distance of 716.55 feet;
Thence North 77°26'17" East, a distance of 950.01 feet;
Thence North 89°24'12" West, a distance of 3469.09 feet;
Thence South 00°23'43" West, a distance of 2634.95 feet;
Thence North 89°18'00" West, a distance of 949.85 feet;
Thence North 00°42'00" East, a distance of 899.86 feet;
Thence North 89°18'00" West, a distance of 1419.78 feet;
Thence South 00°42'00" West, a distance of 899.86 feet;
Thence North 89°17'19" West, a distance of 776.21 feet;
Thence South 00°19'19" West, a distance of 1310.13 feet;
Thence South 88°58'45" East, a distance of 509.96 feet;
Thence South 00°18'08" West, a distance of 1310.88 feet;
Thence South 00°19'54" West, a distance of 2656.03 feet;
Thence North 88°26'18" West, a distance of 1955.32 feet;
Thence South 00°52'39" West, a distance of 659.90 feet;
Thence North 88°26'18" West, a distance of 659.90 feet;
Thence South 00°52'39" West, a distance of 658.57 feet;
Thence North 89°43'48" West, a distance of 3973.78 feet;
Thence North 00°39'00" East, a distance of 1318.91 feet;
Thence North 89°43'23" West, a distance of 1326.34 feet;
Thence South 00°34'28" West, a distance of 1799.72 feet;
Thence North 89°11'18" West, a distance of 1999.69 feet;
Thence North 00°48'42" East, a distance of 480.65 feet;
Thence North 89°11'18" West, a distance of 3303.71 feet;
Thence North 89°51'13" West, a distance of 5267.62 feet;

Thence North 90°00'00" West, a distance of 2640.66 feet;
Thence North 00°40'29" East, a distance of 9276.34 feet;
Thence North 90°00'00" East, a distance of 2640.66 feet;
Thence North 00°46'01" East, a distance of 2633.87 feet;
Thence North 00°22'55" East, a distance of 2633.69 feet;
Thence South 89°23'09" East, a distance of 5269.66 feet;
Thence North 00°29'12" East, a distance of 2633.84 feet;
Thence North 00°30'43" East, a distance of 5267.71 feet;
Thence South 89°12'16" East, a distance of 1310.34 feet;
Thence South 89°12'16" East, a distance of 3931.00 feet;
Thence South 00°16'22" West, a distance of 145.03 feet;
Thence South 88°32'43" East, a distance of 698.08 feet;
Thence South 01°27'17" West, a distance of 129.99 feet;
Thence South 88°32'41" East, a distance of 249.96 feet;
Thence North 01°27'19" East, a distance of 129.99 feet;
Thence South 88°32'41" East, a distance of 638.45 feet;
Thence easterly and to the Left on a 23014.77 foot
Radius Curve an Arc Length of 1404.66 feet, said
Curve having a Chord Bearing of North 89°42'24" East;
Thence North 87°57'30" East, a distance of 126.72 feet;
Thence South 00°20'39" West, a distance of 1025.89 feet;
Thence South 89°39'21" East, a distance of 2164.16 feet;
Thence South 00°17'53" West, a distance of 1494.50 feet;
Thence South 89°17'03" East, a distance of 1354.79 feet;
Thence North 24°09'52" West, a distance of 454.93 feet;
Thence North 47°49'52" West, a distance of 489.92 feet;
Thence North 23°30'22" West, a distance of 149.98 feet;
Thence North 66°20'08" East, a distance of 569.91 feet;
Thence South 23°39'52" East, a distance of 94.99 feet;
Thence South 01°20'08" West, a distance of 514.92 feet;
Thence South 24°09'52" East, a distance of 559.59 feet;
Thence South 89°17'03" East, a distance of 415.24 feet;
Thence South 31°40'08" West, a distance of 486.22 feet;
Thence South 62°44'52" East, a distance of 1049.50 feet;
Thence South 00°13'28" West, a distance of 1743.66 feet;
Thence South 00°26'44" West, a distance of 2630.61 feet;
Thence North 89°22'37" West, a distance of 2625.10 feet;
Thence South 00°29'53" West, a distance of 2632.62 feet;
Thence South 89°20'57" East, a distance of 2627.51 feet;
Thence South 89°20'58" East, a distance of 2627.51 feet;
Thence North 00°21'51" East, a distance of 2635.18 feet;
Thence South 89°30'58" East, a distance of 1989.35 feet;
Thence South 00°21'52" West, a distance of 1247.10 feet;
Thence North 89°27'10" West, a distance of 469.93 feet;
Thence South 00°21'51" West, a distance of 1390.28 feet;
Thence North 89°27'11" West, a distance of 711.30 feet;
Thence South 00°00'00" East, a distance of 206.30 feet;
Thence South 20°35'00" East, a distance of 72.48 feet;

Thence South 59°56'16" East, a distance of 677.25 feet;
Thence South 89°27'10" East, a distance of 2831.91 feet;
Thence South 11°11'44" East, a distance of 802.65 feet;
Thence South 38°28'56" East, a distance of 400.96 feet;
Thence North 89°59'14" East, a distance of 699.91 feet;
Thence South 00°25'00" West, a distance of 641.30 feet;
Thence North 89°59'14" East, a distance of 3424.93 feet;
Thence South 48°56'36" East, a distance of 83.79 feet;
Thence South 68°56'06" East, a distance of 1863.65 feet;
Thence South 00°37'39" West, a distance of 6.31 feet;
Thence South 67°55'55" East, a distance of 3740.14 feet;
Thence South 21°20'31" West, a distance of 199.97 feet;
Thence North 67°55'57" West, a distance of 1218.94 feet;
Thence South 56°16'31" West, a distance of 716.35 feet;
Thence North 89°21'21" West, a distance of 354.22 feet;
Thence South 00°38'39" West, a distance of 551.25 feet;
Thence South 89°52'29" West, a distance of 1297.33 feet to the Point of Beginning.

The above described tract of land contains 9359.28 Acres, more or less.

Parcel 2

Beginning at the Southeast Corner of Section 25, T. 142 N., R. 84 W. ;
(NAD 27-ND State Plane South Zone- US Foot- N: 517,163.7, E: 1,811,461.1);
Thence North 89°27'09" West, a distance of 949.96 feet;
Thence North 00°25'00" East, a distance of 774.80 feet;
Thence South 89°27'09" East, a distance of 949.96 feet;
Thence South 00°25'00" West, a distance of 774.80 feet to the Point of Beginning.

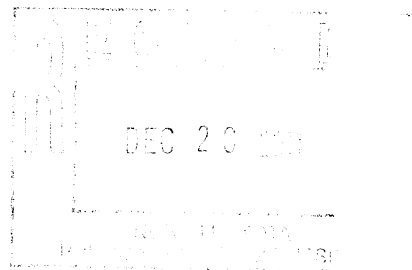
The above described tract of land contains 16.90 Acres, more or less.

Exception 1

Commencing at the North Quarter Corner of Section 3, T. 141 N., R. 84 W. ;
(NAD 27-ND State Plane South Zone- US Foot- N: 512,029.7, E: 1,798,253.5);
Thence South 48°28'54" West, a distance of 338.96 feet to the Point of Beginning;
Thence South 00°00'00" East, a distance of 3700.00 feet;
Thence North 90°00'00" West, a distance of 800.00 feet;
Thence North 00°00'00" West, a distance of 3700.00 feet;
Thence North 90°00'00" East, a distance of 800.00 feet to the Point of Beginning.

The above described tract of land contains 67.95 Acres, more or less.

**ATTACHMENT III
METES & BOUNDS DESCRIPTIONS
FEDERAL COAL
BNCR 8202-8602-9702**



Seven Tracts of Land lying in Sections 2 & 10 of Township 141 North, Range 84 West and Sections 22, 26, 28, 32 & 34 of Township 142 North, Range 84 West of The Fifth Principal Meridian, Oliver County, North Dakota, more fully described as follows:

BNCR 8202 - TRACT 22

A Tract of Land Lying in Section 22, Township 142 North, Range 84 West of The Fifth Principal Meridian, Oliver County, North Dakota, more particularly described as follows:

Commencing at the North Quarter Corner of Said Section 22;
(NAD 27-ND State Plane South Zone- US Foot- N: 527,841.4, E: 1,798,380.0);
Thence South 00°23'27" West, a distance of 151.77 feet to the Point of The Beginning;
Thence Intersecting a Curve Concave To The North, said curve having an arc length of 341.05 feet, a radius of 23014.77 feet, a chord bearing of North 88°22'58" East, a chord length of 341.05 feet and a Delta Angle of 0°50'57";
Thence North 87°57'30" East, a distance of 126.75 feet;
Thence South 00°20'39" West, a distance of 1025.89 feet;
Thence South 89°39'21" East, a distance of 2164.15 feet;
Thence South 00°17'53" West, a distance of 4126.26 feet;
Thence North 89°10'42" West, a distance of 5278.45 feet;
Thence North 00°16'22" East, a distance of 3947.28 feet;
Thence South 89°12'06" East, a distance of 1323.67 feet;
Thence South 00°19'55" West, a distance of 1316.23 feet;
Thence South 89°10'52" East, a distance of 2639.80 feet;
Thence North 00°20'40" East, a distance of 1316.29 feet;
Thence North 89°09'47" West, a distance of 1316.42 feet;
Thence North 00°23'27" East, a distance of 1164.92 feet to the Point of Beginning.

The above described tract of land contains 419.70 Acres, more or less.

BNCR 8202 - TRACT 26

The Northwest Quarter of Section 26, Township 142 North, Range 84 West of The Fifth Principal Meridian, Oliver County, North Dakota, more particularly described as follows:

Beginning at the Northwest Corner of Said Section 26;
(NAD 27-ND State Plane South Zone- US Foot- N: 522,538.7, E: 1,800,983.0);
Thence South 89°20'00" East, a distance of 2622.69 feet;
Thence South 00°26'44" West, a distance of 2630.61 feet;
Thence North 89°20'57" West, a distance of 2625.09 feet;
Thence North 00°29'53" East, a distance of 2632.61 feet to the Point Of Beginning.

The above described tract of land contains 158.52 Acres, more or less.

BNCR 8602 - TRACT 02

A Tract of Land Lying in Section 2, Township 141 North, Range 84 West of The Fifth Principal Meridian, Oliver County, North Dakota, more particularly described as follows:

Beginning at the Northwest Corner of Said Section 2;
(NAD 27-ND State Plane South Zone- US Foot- N: 512,008.7, E: 1,800,883.6);
Thence South 89°16'58" East, a distance of 2126.03 feet;
Thence South 00°19'19" West, a distance of 1310.13 feet;
Thence North 88°58'45" West, a distance of 805.34 feet;
Thence South 00°12'04" West, a distance of 1306.86 feet;
Thence North 88°48'09" West, a distance of 1312.60 feet;
Thence North 00°04'45" East, a distance of 2601.80 feet to the Point of beginning.

The above described tract of land contains 102.94 Acres, more or less.

BNCR 9702 - TRACT 10

A Tract of Land Lying in Section 10, Township 141 North, Range 84 West of The Fifth Principal Meridian, Oliver County, North Dakota, more particularly described as follows:

Beginning at the Northeast Corner of Said Section 10;
(NAD 27-ND State Plane South Zone- US Foot- N: 506,767.3, E: 1,800,875.5);
Thence South 00°52'39" West, a distance of 1318.47 feet;
Thence North 89°43'48" West, a distance of 3973.78 feet;
Thence North 00°39'00" East, a distance of 1318.91 feet;
Thence South 89°43'23" East, a distance of 3979.01 feet to the Point Of Beginning.

The above described tract of land contains 120.37 Acres, More Or Less.

BNCR 9702 - TRACT 28

The West Half of Section 28, Township 142 North, Range 84 West of The Fifth Principal Meridian, Oliver County, North Dakota, more particularly described as follows:

Beginning at the South Quarter Corner of Said Section 28;
(NAD 27-ND State Plane South Zone- US Foot- N: 517,378.8, E: 1,793,032.6);
Thence North 89°12'30" West, a distance of 2635.32 feet;
Thence North 00°29'11" East, a distance of 5267.68 feet;
Thence South 89°15'25" East, a distance of 2631.63 feet;
Thence South 00°26'48" West, a distance of 5269.93 feet to the Point Of Beginning.

The above described tract of land contains 318.53 Acres, More Or Less.

BNCR 9702 - TRACT 32

A Tract of Land Lying in Section 32, Township 142 North, Range 84 West of The Fifth Principal Meridian, Oliver County, North Dakota, more particularly described as follows:

Beginning at the Northwest Corner of Said Section 32;
(NAD 27-ND State Plane South Zone- US Foot- N: 517,471.8, E: 1,785,133.0);
Thence South 89°23'02" East, a distance of 2632.42 feet;
Thence South 00°45'07" West, a distance of 1318.47 feet;
Thence North 89°21'02" West, a distance of 1316.38 feet;
Thence South 00°45'34" West, a distance of 2635.40 feet;
Thence North 89°17'00" West, a distance of 1316.72 feet;
Thence North 00°46'01" East, a distance of 1316.93 feet;
Thence North 00°46'01" East, a distance of 2633.87 feet to the Point Of Beginning.

The above described tract of land contains 159.26 Acres, More Or Less.

BNCR 9702 - TRACT 34

A Tract of Land Lying in Section 34, Township 142 North, Range 84 West of The Fifth Principal Meridian, Oliver County, North Dakota, more particularly described as follows:

Beginning at the Northeast Corner of Said Section 34;
(NAD 27-ND State Plane South Zone- US Foot- N: 517,273.7, E: 1,800,937.2);
Thence South 00°34'59" West, a distance of 3948.99 feet;
Thence North 89°25'29" West, a distance of 2631.45 feet;
Thence North 00°31'55" East, a distance of 1321.70 feet;
Thence North 89°18'28" West, a distance of 1320.28 feet;
Thence North 00°35'32" East, a distance of 2636.42 feet;
Thence South 89°15'12" East, a distance of 3952.51 feet to the Point Of Beginning.

The above described tract of land contains 318.76 Acres, More Or Less.

A drawing is attached to this document.

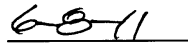
Notes:

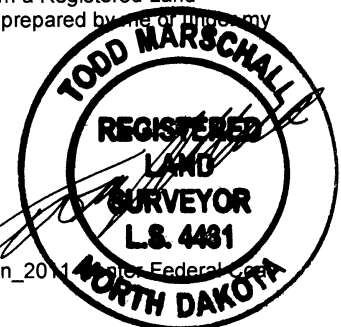
1. The basis of this survey is the 1927 North Dakota State Plane System, South Zone, US Survey Feet, 1993 MSI control. Details are available upon request @ 701-794-8735 ext. 260.
2. Survey control was re-established in 1993 by Measurement Sciences, Inc. using Trimble 4000 GPS receivers and Trimble software.
3. Additional survey control was established in 1994 by Ulteig Engineers using Sokkia 3BII total station (laser). Corrected coordinates for existing Land Corners and additional Land Corners were also established in 1995 and 1996 by Ulteig Engineers.
4. A current digital ortho photo of the land is available for use in AutoCAD.
5. For electronic drawings, this drawing was originally issued and sealed by Todd Marschall, R.L.S. 4431, and is stored at BNI Coal Inc., 2360 35th Ave. SW, Center, ND 58530-9499.
6. Electronic version saved as shown in the footer.
7. This document is not expected to perfectly match other documents with a different basis of survey. Round off error should be expected.

Certification:

I, Todd Marschall, hereby certify that this drawing is a reasonable representation and that I am a Registered Land Surveyor in the State of North Dakota. I hereby certify that the plan shown on this sheet was prepared by me or under my direct supervision. Any alterations to this drawing will void my Certification.


Todd Marschall R.L.S. 4431


Date





2011 Quarterly Report

SEPTEMBER 30, 2011

Dear CoBank Customer-Owner:

We're pleased to report that CoBank achieved another period of strong financial performance in the third quarter of 2011. Quarterly net income rose 29 percent to \$169.9 million, compared with \$132.0 million in the third quarter of 2010. Net interest income for the quarter was \$252.0 million, compared with \$226.3 million a year ago. Average loan volume for the third quarter was \$47.6 billion, compared to \$44.5 billion for the same period in 2010.

For the first nine months of 2011, net income increased 25 percent to \$562.7 million compared to \$451.0 million during the same period in 2010. Net interest income increased 23 percent to \$829.7 million, from \$674.9 million for the same period in 2010. Total loan volume for the bank at September 30, 2011 was \$45.0 billion.

Higher prices for grains and other agricultural commodities had a significant impact on the bank's financial results, as has been the case for several consecutive quarters. Many of our agribusiness customers finance their inventories and receivables, and they borrow more from CoBank when commodity prices are higher and more volatile. Throughout most of 2011, prices for corn, wheat, soybeans and other agricultural products have been higher than they were in 2010, increasing our loan volume. At the same time, loan growth with rural infrastructure customers and Farm Credit associations has been modest, consistent with slow growth in the broader U.S. economy. While we're pleased with our quarterly and year-to-date results, we also recognize that loan demand from agribusiness customers may moderate or even decline in the event of a commodity market slowdown.

Credit risk in CoBank's loan portfolio remains well within the bank's risk-bearing capacity. At quarter end, 1.46 percent of the bank's loans were classified as adverse assets, compared with 1.87 percent at June 30, 2011, and 1.71 percent at December 31, 2010. Nonaccrual loans decreased to \$160.7 million, from \$191.3 million at the end of the second quarter and \$167.0 million at the end of the prior year. During the third quarter, the bank recorded a \$12.5 million provision for loan losses, bringing the year-to-date provision to \$50.0 million. The provision for loan losses in the first nine months of last year was \$37.5 million. Net charge-offs for the first nine months of 2011 were \$17.1 million compared to \$38.2 million for the same period in 2010.

The bank's reserve for credit exposure totals \$533.4 million at September 30, 2011, or 1.99 percent of non-guaranteed loans outstanding when loans to Farm Credit associations are excluded. We continue to build a strong reserve, which protects the bank's capital base in the event of credit losses in our loan portfolio.

Capital levels at the bank remain solid and well in excess of regulatory minimums. As of September 30, 2011, shareholders' equity totaled \$4.9 billion, and the bank's permanent capital ratio was 15.7 percent, compared with the 7.0 percent minimum established by the Farm Credit Administration (FCA), the bank's regulator.

At quarter end, CoBank held approximately \$16.0 billion in cash and investments. The bank averaged 190 days of liquidity during the first nine months of the year, compared with the 90-day regulatory minimum set by the FCA. The bank recorded \$2.0 million in impairment losses on investment securities during the third quarter, primarily due to continued weakness in the U.S. housing market and broader economy, and the related impact on certain mortgage- and asset-backed securities held by the bank. However, credit risk in this portfolio is limited given that approximately 97 percent of our investment securities carry an implied or explicit guarantee from the U.S. government. Through the first nine months of 2011, impairment losses have totaled \$6.0 million, compared with \$39.0 million during the same period last year.

U.S. AgBank Merger Update

As previously announced, CoBank has executed a letter of intent to merge with U.S. AgBank, another bank in the Farm Credit System. The combined bank is expected to have approximately \$90 billion in assets and serve as a wholesale provider of financing to Farm Credit associations as well as a direct lender to farmer-owned agricultural cooperatives, infrastructure companies and other rural businesses. On a combined basis, the bank will provide credit and financial services to more than 70,000 farmers and ranchers in 23 states, and cooperative and other retail customers nationwide. The bank will do business under the CoBank name and remain headquartered in Colorado, with Bob Engel continuing in the role of chief executive officer.

On September 7, 2011, the merger received approval from the stockholders of both banks. Final approval from the FCA is expected during the fourth quarter, and the banks plan to formally close the merger January 1, 2012. We believe the merger will create a stronger, more durable financial services institution with an enhanced ability to fulfill its mission, both today and for future generations of rural borrowers.

We are focused on managing the bank for the long term, and on meeting the needs of all our customers in economic conditions that should remain volatile and challenging for the foreseeable future. As always, our board and associates are grateful for our relationship with our customer-owners and ever mindful of the enormous trust they place in CoBank. We thank you for your ongoing support and look forward to reporting to you on our future progress.

Everett Dobrinski
Chairman of the Board

Robert B. Engel
President and Chief Executive Officer

November 9, 2011

Financial Highlights

CoBank, ACB

(\$ in Thousands)

| | September 30, 2011 (Unaudited) | December 31, 2010 |
|---------------------------------|-----------------------------------|-------------------|
| Total Loans | \$ 45,027,900 | \$ 49,992,338 |
| Less: Allowance for Loan Losses | 390,813 | 400,744 |
| Net Loans | 44,637,087 | 49,591,594 |
| Total Assets | 62,335,829 | 65,825,890 |
| Total Shareholders' Equity | 4,855,255 | 4,406,197 |

For the Nine Months Ended September 30,

| (Unaudited) | 2011 | 2010 |
|---|---------------|---------------|
| Net Interest Income | \$ 829,736 | \$ 674,899 |
| Provision for Loan Losses | 50,000 | 37,500 |
| Net Fee Income | 82,556 | 71,389 |
| Net Income | 562,706 | 450,989 |
| Net Interest Margin | 1.72 % | 1.61 % |
| Return on Average Assets | 1.11 | 1.04 |
| Return on Average Common Shareholders' Equity | 17.44 | 15.22 |
| Return on Average Total Shareholders' Equity | 16.19 | 14.22 |
| Average Loans | \$ 51,510,670 | \$ 44,131,147 |
| Average Earning Assets | 64,655,056 | 55,885,037 |
| Average Assets | 67,735,255 | 58,223,465 |

Management's Discussion and Analysis of Financial Condition and Results of Operations

CoBank, ACB

Business Overview

CoBank, ACB (CoBank or the Bank) is one of the five Banks of the Farm Credit System (System), a federally chartered network of borrower-owned lending institutions composed of cooperatives and related service organizations. We are cooperatively owned by our U.S. customers, who consist of agricultural cooperatives, rural energy, communications and water companies, farmer-owned financial institutions, including Agricultural Credit Associations (Associations), and other businesses that serve rural America. We provide a diversified range of financial services to vital industries through three operating segments: Agribusiness, Strategic Relationships and Rural Infrastructure.

The following discussion and analysis should be read in conjunction with the accompanying condensed consolidated quarterly financial statements and related notes and with our 2010 Annual Report to Shareholders.

Consolidated Results of Operations

CoBank posted strong financial results for the first nine months of 2011. Net income increased 25 percent to \$562.7 million for the nine months ended September 30, 2011, compared to \$451.0 million during the same period in 2010. Our stronger earnings reflected a significant increase in net interest income, which resulted from greater seasonal loan growth in our Agribusiness operating segment. To a lesser extent, earnings also increased due to reduced impairment losses in our investment securities portfolio. Our provision for loan losses, operating expenses and provision for income taxes were all higher for the first nine months of 2011 and somewhat offset the increases in net interest income and noninterest income.

Net interest income increased 23 percent to \$829.7 million for the nine months ended September 30, 2011, compared to \$674.9 million for the same period in 2010. The sharp increase in net interest income primarily resulted from a \$7.4 billion increase in average loan volume. The most substantial increases were in seasonal loans to our Agribusiness customers, as higher and continued volatile prices for grains and certain other agricultural commodities led to greater customer financing requirements. To a much lesser extent, we also experienced year-over-year loan growth in our Rural Infrastructure and Strategic Relationships operating segments. Rural Infrastructure loan growth was primarily the result of increased volume in the electric distribution division, while Strategic Relationships loan volume increased due to modest growth at our affiliated Associations. Notwithstanding growth in average loan volume in the 2011 period, period-end loans decreased to \$45.0 billion at September 30, 2011 compared to \$50.0 billion at December 31, 2010. The decrease in loan volume since year-end is primarily due to the typical seasonal decline in agribusiness loans; however, demand for financing in many of the other sectors we serve continues to be weak, consistent with slow growth in the broader U.S. economy.

Our overall net interest margin was 1.72 percent for the nine months ended September 30, 2011, compared to 1.61 percent for the same period in 2010, primarily reflecting a greater level of average agribusiness loan volume. Partially offsetting this net interest margin increase were lower returns on our invested capital due to declining intermediate-term interest rates. Additionally, increased competition from commercial banks and debt markets have placed downward pressure on the Bank's lending spreads in certain customer segments.

We recorded a \$50.0 million provision for loan losses in the first nine months of 2011, compared to \$37.5 million for the same period in 2010. The 2011 provision primarily relates to a higher level of commitments in our Agribusiness operating segment and credit challenges facing a small number of customers in our Agribusiness and Rural Infrastructure operating segments. The 2010 provision primarily related to our Rural Infrastructure operating segment, somewhat offset by a reversal in the reserve for credit exposure in our Agribusiness operating segment. Our overall credit quality improved modestly in the third quarter and is generally consistent with year-end 2010 levels. Adverse assets decreased to 1.46 percent of total loans and related accrued interest at September 30, 2011 compared to 1.71 percent at December 31, 2010. Nonaccrual loans decreased from \$167.0 million at December 31, 2010 to \$160.7 million at September 30, 2011. Net charge-offs for the first nine months of 2011 were \$17.1 million compared to \$38.2 million for the same period in 2010. Our loan quality is discussed in further detail beginning on page 9.

Noninterest income increased to \$92.5 million for the nine months ended September 30, 2011 from \$78.4 million for the same period in 2010. Noninterest income is composed primarily of net fee income, loan prepayment fee income and miscellaneous gains and losses, reduced by losses on early extinguishments of debt and impairment losses on investment securities. The increase in noninterest income resulted primarily from a decrease in the level of impairment losses in our investment securities portfolio and higher fee income. We recorded impairment losses of \$6.0 million in our investment portfolio in the first nine months of 2011 as compared to \$39.0 million in the 2010 period. These impairment losses are described on page 10. Noninterest income for the nine months ended September 30, 2011 also included a \$4.5 million gain on the sale of one of our previously impaired investment securities. Net fee income increased to \$82.6 million for the nine months ended September 30, 2011 from \$71.4 million for the same period in 2010 and was primarily driven by greater arrangement fees earned on transactions in our agribusiness and rural energy portfolios. Noninterest income in 2010 included \$33.3 million in refunds of Farm Credit insurance fund premiums. These refunds were classified as miscellaneous gains and losses, which are included in 'Other, Net' within the 'Noninterest Income/Expense' section of the accompanying condensed consolidated statement of income for the nine months ended September 30, 2010. There were no insurance fund premium refunds during the first nine months of 2011. In addition, losses on early extinguishments of debt, net of prepayment income, increased \$10.2 million for the first nine months of 2011 compared to the 2010 period. This change resulted from increased debt buyback losses incurred in an effort to achieve the desired mix of interest-bearing liabilities in a low interest rate environment.

Total operating expenses for the nine months ended September 30, 2011 increased to \$165.5 million from \$153.1 million for the same period in 2010. Employee compensation expense increased \$14.1 million due to higher incentive compensation expense related to stronger financial performance and increased employee staffing levels. Insurance fund premium expense increased \$6.4 million primarily due to an increase in insured debt obligations which funded the increase in average loan volume. In addition, premium rates for the nine months ended September 30, 2011 were six basis points of average outstanding adjusted insured debt obligations, compared to five basis points for 2010. For the nine months ended September 30, 2011, we recorded expenses of \$12.9 million related to the proposed merger with U.S. AgBank. Merger expenses are primarily included in purchased services and general and administrative expenses. The proposed merger with U.S. AgBank is further discussed in "Recent Developments" on page 12. General and administrative expenses decreased \$16.3 million in the 2011 period, as the prior-year period included costs related to the settlement of a business dispute in our Rural Infrastructure operating segment.

Our income tax expense increased to \$143.9 million for the nine months ended September 30, 2011, compared to \$111.7 million for the same prior-year period. Increased tax expense is a direct result of the improvement in our pre-tax earnings. Our effective tax rate was 20.4 percent and 19.9 percent for the nine months ended September 30, 2011 and 2010, respectively, reflecting increased earnings in the taxable portion of CoBank's business activities.

Our annualized return on average common shareholders' equity, a reflection of our overall earnings, increased to 17.44 percent for the nine months ended September 30, 2011 from 15.22 percent for the same period in 2010. As a result of the growth in average agribusiness loans noted previously, our annualized return on average assets increased to 1.11 percent for the nine months ended September 30, 2011, compared to 1.04 percent for the same period in 2010.

For the three months ended September 30, 2011, net income rose 29 percent to \$169.9 million from \$132.0 million for the same prior-year period. The increase was primarily due to a \$25.7 million increase in net interest income, reflective of an increase in average loan volume, as previously discussed. Additionally, noninterest income grew by \$25.0 million primarily due to a \$23.0 million decrease in impairment losses on investment securities and greater fee income, which more than offset higher losses on early extinguishments of debt. Our provision for loan losses decreased \$8.5 million, as the 2010 period included provision related to credit challenges facing a small number of customers in our rural energy portfolio at that time. Partially offsetting these items was an increase of \$12.8 million in operating expenses, largely due to merger costs and increased employee compensation, as explained above.

Operating Segment Financial Review

We provide financial services to farmer-owned cooperatives; farmer-owned financial institutions; providers of energy, communications and water services; and other businesses that serve rural America. We conduct lending operations through three operating segments: Agribusiness, Strategic Relationships and Rural Infrastructure.

Loans outstanding and the allowance for loan losses by operating segment at September 30, 2011 and 2010 are reported in Notes 2 and 8 to the accompanying condensed consolidated financial statements. Net income by operating segment is summarized in the following table and is more fully detailed in Note 8 to the accompanying condensed consolidated financial statements.

Net interest income on investment securities and gains and losses on investment securities are allocated to all operating segments, whereas the underlying investment assets are not allocated.

| Net Income by Operating Segment (\$ in Thousands) | | |
|---|-------------------|-------------------|
| For the Nine Months Ended September 30, | 2011 | 2010 |
| Operating Segment: | | |
| Agribusiness | \$ 353,795 | \$ 269,008 |
| Strategic Relationships | 63,411 | 60,504 |
| Rural Infrastructure | 150,199 | 127,323 |
| Total Operating Segments | 567,405 | 456,835 |
| Corporate/Other | (4,699) | (5,846) |
| Total | \$ 562,706 | \$ 450,989 |

Agribusiness

The Agribusiness operating segment includes loans and financial services provided to cooperatives and other businesses engaged in agricultural activities such as grain handling and marketing, farm supply, food processing, dairy, livestock, fruits, nuts, vegetables, cotton, biofuels and forest products. Our Agribusiness segment also includes our agricultural export finance division, which provides short-term and medium-term trade finance to support the export of U.S. agricultural products. As of September 30, 2011, we had \$3.9 billion in loans financing agribusiness exports, 79 percent of which were guaranteed by the U.S. government. In addition, our Agribusiness segment includes Farm Credit Leasing Services Corporation (FCL), which provides lease-related financial services to Association partners, agribusinesses, agricultural producers and rural utilities. As of September 30, 2011, FCL had \$1.8 billion in leases outstanding.

Agribusiness average loan volume increased 38 percent to \$24.5 billion for the first nine months of 2011 from \$17.7 billion for the same period of 2010. The significant increase in loan volume primarily resulted from sustained higher and continued volatile prices for grains and certain other agricultural commodities that drove increased seasonal borrowing by agribusiness customers, particularly those in the farm supply and grain marketing sectors. Generally, higher and volatile prices for agricultural commodities lead to increased financing requirements for many of these customers, which borrow to finance inventories and receivables. Agribusiness period-end loan volume decreased from \$22.7 billion at December 31, 2010 to \$17.9 billion at September 30, 2011. Agribusiness loan volume is generally at a seasonal low in late summer or early fall before harvest financing demands result in loan volume increases beginning in late fall of each year and peaking in late winter or early spring.

Agribusiness net income increased 32 percent in the first nine months of 2011 to \$353.8 million from \$269.0 million for the same period in 2010. This increase resulted primarily from a \$163.7 million increase in net interest income due to the significant increase in loan volume partially offset by lower returns on invested capital, as previously described. Agribusiness recorded a provision for loan losses of \$39.5 million during the first nine months of 2011, as compared to a reversal in the reserve for credit exposure of \$7.0 million in the same prior-year period. The current period provision primarily reflects an overall higher level of Agribusiness commitments as well as credit challenges facing a small number of customers. Nonaccrual loans increased to \$107.5 million at September 30, 2011 compared to \$93.4 million at December 31, 2010, reflecting specific customer credit challenges. Agribusiness recorded net charge-offs of \$6.6 million for the nine months ended September 30, 2011 compared to \$18.7 million for the same period of 2010.

Agribusiness noninterest income increased to \$62.7 million for the first nine months of 2011, as compared to \$48.0 million in the same period of 2010, due to a decrease in the level of investment impairment losses and an increase in net fee income, which was driven primarily by greater arrangement fees. The 2011 period also included a gain on the sale of an investment security. As described on page 5, the 2010 period included refunds of a portion of insurance fund premiums paid in prior years. Operating expenses increased to \$106.2 million for the first nine months of 2011 from \$78.7 million in the 2010 period due to greater employee compensation expense, merger expenses and insurance fund premiums, as previously described. In addition, the prior-year period included a reversal of accrued legal settlement expenses. Income tax expense in the Agribusiness operating segment increased \$19.7 million due to the growth in pre-tax earnings.

Strategic Relationships

The Strategic Relationships operating segment includes loans from the direct funding relationships we have with our four affiliated Association customer-owners (Farm Credit East, Farm Credit of Maine, Northwest Farm Credit Services and Yankee Farm Credit) and our funding relationships with other System institutions. As of September 30, 2011, the Strategic Relationships portfolio included \$11.2 billion in loans to our four affiliated Associations and \$4.0 billion of participations in loans made by other System banks to certain of their affiliated Associations, including \$3.4 billion of participations in loans made by the Farm Credit Bank of Texas.

Strategic Relationships average loan volume was \$15.2 billion for the nine-month period ended September 30, 2011, as compared to \$15.0 billion for the nine months ended September 30, 2010, due to modest growth at our affiliated Associations. Strategic Relationships net income increased slightly to \$63.4 million for the first nine months of 2011, as compared to \$60.5 million for the same prior-year period, due primarily to a \$4.5 million increase in net interest income, partially offset by the impact of merger expenses.

The overall loan quality in our Strategic Relationships portfolio remains strong. As a wholesale lender to Association customers, we benefit from the diversification of the Association loan portfolios and our strong collateral position. In addition, the earnings, capital and loan loss reserves of the Associations provide us a buffer from losses in their respective loan portfolios. Lower margins in the Strategic Relationships operating segment are commensurate with the lower risk profile and lower regulatory capital requirements. No provision for loan losses or reserve for credit exposure (RCE) has been recorded related to any Association loan. As discussed on page 9, the credit quality classification of a loan to a nonaffiliated Association was upgraded in the third quarter of 2011 from the 'Substandard' to the 'Special Mention' category.

Rural Infrastructure

The Rural Infrastructure operating segment includes loans and financial services provided to companies in the energy, communications and water industries. Customers include rural electric generation and transmission cooperatives, electric distribution cooperatives, renewable energy providers, independent power producers, rural local exchange carriers, wireless providers, data transport networks, cable television systems, and water and waste water companies.

Rural Infrastructure average loan volume increased to \$11.8 billion for the first nine months of 2011 from \$11.4 billion for the same period in 2010. Growth in Rural Infrastructure average loan volume resulted from increased lending activity in the electric distribution division driven primarily by the refinancing of borrowings from other lenders. This growth was partially offset by a decline in loans to our communications customers, reflecting weak demand for debt capital and increased availability of government stimulus funding in certain sectors of the communications industry.

Rural Infrastructure net income increased 18 percent to \$150.2 million for the first nine months of 2011 from \$127.3 million for the same period in 2010, largely due to a \$34.0 million decrease in the provision for loan losses and a \$13.1 million decrease in operating expenses. Rural Infrastructure recorded a provision for loan losses of \$10.5 million for the first nine months of 2011, as compared to \$44.5 million for the same period in 2010. The decrease resulted from the resolution of a troubled loan in the communications division in 2011, as well as greater provisions in the 2010 period for specific customers in our rural energy portfolio. Nonaccrual loans in the Rural Infrastructure segment decreased to \$53.2 million at September 30, 2011 from \$73.6 million at December 31, 2010. Rural Infrastructure recorded net charge-offs of \$10.5 million for the nine months ended September 30, 2011, as compared to \$19.5 million for the same period of 2010.

Operating expenses decreased to \$48.0 million for the first nine months of 2011, as compared to \$61.1 million in the same prior-year period. The decrease resulted primarily from costs related to the settlement of a business dispute that were recorded in the 2010 period. Excluding such prior-period costs, operating expenses in 2011 increased primarily due to greater employee compensation and merger costs, and to a lesser extent, increased insurance fund premium expenses, as previously described.

Rural Infrastructure net interest income decreased to \$222.8 million for the first nine months of 2011 from \$234.9 million for the same period in 2010 primarily due to lower returns on our invested capital, as previously described, partially offset by an increase in average loan volume. Noninterest income increased slightly to \$30.8 million for the first nine months of 2011, as compared to \$30.3 million in the same period of 2010 due to a decrease in the level of investment impairment losses, the gain on the sale of an investment security and increased fee income. The 2010 period included refunds of a portion of insurance fund premiums paid in prior years, as previously described on page 5. Rural Infrastructure income tax expense increased \$12.6 million due to the growth in its pre-tax earnings.

Credit Quality, Liquidity, Capital Resources and Other

Loan Quality

The following table presents loans and related accrued interest receivable classified, by management, pursuant to our regulator's Uniform Loan Classification System, as a percent of total loans and related accrued interest.

| Loan Quality Ratios | | |
|---------------------|--------------------|-------------------|
| | September 30, 2011 | December 31, 2010 |
| Acceptable | 94.46 % | 94.76 % |
| Special Mention | 4.08 | 3.53 |
| Substandard | 1.40 | 1.62 |
| Doubtful | 0.06 | 0.09 |
| Loss | - | - |
| Total | 100.00 % | 100.00 % |

Our overall credit quality improved modestly in the third quarter and is generally consistent with year-end 2010 levels. Adversely classified loans ('Substandard' and 'Doubtful') decreased to 1.46 percent of total loans and related accrued interest at September 30, 2011 compared to 1.71 percent at December 31, 2010 while the level of 'Special Mention' loans increased to 4.08 percent at September 30, 2011 from 3.53 percent at December 31, 2010. These changes were driven primarily by an upgrade in the credit quality classification of a \$150.0 million loan to a nonaffiliated Association from the 'Substandard' to the 'Special Mention' category.

Total nonaccrual loans decreased to \$160.7 million at September 30, 2011, as compared to \$167.0 million at December 31, 2010. We recorded a \$50.0 million provision for loan losses for the nine months ended September 30, 2011, primarily due to a higher level of commitments in our Agribusiness operating segment and credit challenges facing a small number of customers in our Agribusiness and Rural Infrastructure operating segments. Net charge-offs for the first nine months of 2011 totaled \$17.1 million compared to \$38.2 million in the 2010 period. Our total reserve for credit exposure was \$533.4 million at September 30, 2011, compared to \$500.5 million at December 31, 2010. RCE as a percent of total loans was 1.18 percent at September 30, 2011, compared to 1.00 percent at December 31, 2010. RCE as a percent of non-guaranteed loans outstanding (excluding loans to Associations) was 1.99 percent and 1.60 percent at September 30, 2011 and December 31, 2010, respectively.

Liquidity and Investments

Our liquidity management objectives are designed to meet maturing debt obligations, provide a reliable source of funding to borrowers, provide additional liquidity if market conditions deteriorate for a period of time and fund operations on a cost-effective basis. While we believe that sufficient resources are available to meet liquidity management objectives through our debt maturity structure, holdings of liquid assets and access to the capital markets via the Federal Farm Credit Banks Funding Corporation, the volatility of our loan volume causes our liquidity needs to vary significantly from day to day.

We monitor our liquidity position by assuming no ability to issue debt and calculating the number of days into the future we could meet maturing debt obligations by using available cash and liquidating investments. During the first nine months of 2011, we averaged 190 days liquidity, compared to the regulatory minimum of 90 days. At September 30, 2011, our liquidity was 244 days, compared to 198 days at December 31, 2010.

We hold cash and investment securities to maintain a liquidity reserve and to manage short-term surplus funds. Our investment securities totaled \$13.2 billion at September 30, 2011 compared to \$12.6 billion at December 31, 2010. The following table summarizes our investment securities and related unrealized gains/losses by asset class.

Investment Securities (\$ in Millions)

| | As of September 30, 2011 | | | As of December 31, 2010 | | |
|-------------------------------|--------------------------|------------------|-------------------|-------------------------|------------------|-------------------|
| | Amortized Cost | Fair Value | Unrealized | Amortized Cost | Fair Value | Unrealized |
| | | | Gains (Losses) | | | Gains (Losses) |
| U.S. Treasury and Agency Debt | \$ 3,789 | \$ 3,876 | \$ 87 | \$ 3,311 | \$ 3,358 | \$ 47 |
| U.S. Agency Mortgage-Backed | 8,777 | 9,016 | 239 | 8,673 | 8,739 | 66 |
| Non-Agency Mortgage-Backed | 297 | 279 | (18) | 424 | 402 | (22) |
| Asset-Backed | 83 | 66 | (17) | 143 | 118 | (25) |
| Total | \$ 12,946 | \$ 13,237 | \$ 291 | \$ 12,551 | \$ 12,617 | \$ 66 |

We do not intend to sell the securities in unrealized loss positions and we believe it is unlikely that we will be required to sell such securities for regulatory, liquidity or other purposes before an anticipated recovery of our cost basis occurs. Therefore, with the exception of certain securities discussed below, we do not consider these investments to be other-than-temporarily impaired at September 30, 2011. We regularly perform impairment assessments of our investment securities based on evaluations of both current and future market and credit conditions and expected cash flows of these securities. Subsequent changes in market and credit conditions or expected cash flows could change these evaluations.

As all of our investment securities are classified as “available for sale”, we recognize changes in the fair value of our investment securities in accumulated other comprehensive income (loss), a component of shareholders’ equity, unless losses are credit-related and considered other-than-temporary, in which case that portion of the loss is recorded in earnings. We recorded unrealized gains of \$225.4 million (\$139.8 million net of tax) for the first nine months of 2011, compared to \$160.4 million (\$99.5 million net of tax) for the same prior-year period. The unrealized gains in both periods primarily relate to the impact of interest rate changes on the values of certain fixed-rate securities.

Credit risk in our investment portfolio is primarily limited to the 3 percent of investment securities that do not include either an implied or explicit guarantee of the U.S. government, consisting of non-agency mortgage-backed securities (non-agency MBS) and asset-backed securities (ABS). During the first nine months of 2011, we recorded \$6.0 million in impairment losses related to four non-agency MBS and two ABS. We sold one of our ABS that was previously impaired and recorded a gain on disposition of \$4.5 million during the nine months ended September 30, 2011. We recorded \$39.0 million in impairment losses in the first nine months of 2010 related to three non-agency MBS and seven ABS. In the third quarter of 2010, we determined we could no longer rely on a bond insurer to fulfill its obligations related to certain ABS it insures, which resulted in \$23.0 million of the \$39.0 million of impairment losses recorded in the 2010 period. Increasing levels of defaults and foreclosures on residential mortgages, continued high unemployment, and weak economic conditions may result in further downward adjustments to the fair value of our non-agency MBS and ABS and the need to record additional impairment losses in earnings.

Pursuant to Farm Credit Administration (FCA) regulations, non-agency MBS and ABS that are no longer rated triple-A by at least one major rating agency must be excluded from our liquidity reserve. In addition, such securities must be disposed of within six months of being downgraded unless approval to continue to hold these securities is obtained from the FCA. The total amortized cost and fair value of non-agency MBS and ABS no longer rated triple-A by at least one major rating agency was \$315.7 million and \$282.3 million, respectively, as of September 30, 2011. These securities are not included in our liquidity reserve. With the exception of three securities pending approval, the FCA has granted us approval to continue to hold all such securities.

In August 2011, the FCA published for comment a proposed rule to revise investment management regulations for System institutions. The System is developing a response to the proposed rule. We do not currently believe that any contemplated changes will significantly impact our results of operations or financial condition.

Capital Resources

We are primarily capitalized by holders of our common and preferred stock and by unallocated retained earnings. At September 30, 2011, our permanent capital, total surplus, core surplus and net collateral ratios exceeded the regulatory minimums, as depicted in the following table. The components of these ratios are described in our 2010 Annual Report.

| Capital Ratios | Regulatory Minumums | September 30, 2011 | December 31, 2010 |
|-------------------------|------------------------|-----------------------|----------------------|
| Permanent Capital Ratio | 7.00 % | 15.72 % | 14.30 % |
| Total Surplus Ratio | 7.00 | 15.37 | 13.96 |
| Core Surplus Ratio | 3.50 | 9.56 | 8.42 |
| Net Collateral Ratio | 104.00 * | 109.03 | 108.03 |

* The regulatory minimum net collateral ratio is 103.0 percent, but the FCA requires the higher 104.0 percent during the period in which we have Series A preferred stock or subordinated debt outstanding.

Pursuant to FCA guidance, beginning July 1, 2011, our Series A Cumulative Perpetual Preferred Stock, which totaled \$163.3 million at September 30, 2011, began losing equity treatment for regulatory capital purposes due to a dividend step-up feature in its structure. As a result, the Series A preferred stock is being phased out of our permanent capital, total surplus and net collateral ratios at a rate of 20 percent per annum. The impact to each of these regulatory capital and collateral ratios is expected to be less than 0.1 percent during the remainder of 2011.

The FCA has issued Advance Notices of Proposed Rulemaking on capital adequacy which could ultimately lead to significant changes in the System's regulatory capital rules.

Interest Rate Risk Management

Interest rate risk is primarily managed by adjusting the Bank's mix of interest-sensitive assets and liabilities through various strategies and through the execution of interest rate risk management products, including interest rate swaps and other financial instruments (derivatives). Derivatives are recorded at fair value as assets or liabilities on the consolidated balance sheets. Changes in the fair value of these derivatives are accounted for as gains or losses through current period earnings or as a component of accumulated other comprehensive income (loss), depending on the use of the derivatives and whether they qualify for hedge accounting treatment. Net changes in the fair value of derivatives and hedged items recorded in the consolidated statements of income totaled gains of \$8.4 million and \$0.4 million in the first nine months of 2011 and 2010, respectively. Changes in the fair value of derivatives recorded in other comprehensive income (loss) totaled losses of \$1.8 million (\$1.1 million net of tax), and \$8.2 million (\$5.1 million net of tax), in the first nine months of 2011 and 2010, respectively.

Recent Accounting Pronouncements

In April 2011, the Financial Accounting Standards Board (FASB) issued guidance clarifying when a loan modification or restructuring is considered a troubled debt restructuring. The FASB's guidance provides criteria that a lender should evaluate in determining whether a borrower is experiencing financial difficulties and when a restructuring constitutes a concession. For nonpublic entities, the guidance is effective for annual periods ending on or after December 15, 2012, including interim periods within those annual periods. Early adoption is permitted. The adoption of these provisions is not expected to have a material effect on our consolidated financial position, results of operations or cash flows, but may impact certain loan disclosures.

In May 2011, the FASB issued guidance clarifying certain aspects of fair value measurement and disclosure requirements. The guidance is effective prospectively for reporting periods (including interim periods) beginning after December 15, 2011. Early adoption is not permitted. The adoption of these provisions is not expected to have a material effect on our consolidated financial position, results of operations or cash flows, but is expected to result in additional fair value disclosures surrounding our Level 3 inputs, which are discussed in Note 5 to the accompanying condensed consolidated financial statements.

In June 2011, the FASB issued guidance which revises the manner in which entities present comprehensive income in their financial statements. The new guidance requires entities to report components of comprehensive income in either (1) a continuous statement of comprehensive income; or (2) two separate but consecutive statements. The guidance does not change the items that must be reported in other comprehensive income. These provisions are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. The adoption of these provisions will not impact our consolidated financial position, results of operations or cash flows; however, it will result in changes to the presentation of comprehensive income.

Recent Developments

Proposed Merger with U.S. AgBank, FCB

As discussed in our 2010 Annual Report, in December 2010 the Boards of Directors of CoBank and U.S. AgBank, FCB unanimously approved a Letter of Intent to pursue a merger. In March 2011, following unanimous votes by the Boards, a merger application was submitted to the FCA, and on June 22, 2011, the FCA granted preliminary approval of the merger, subject to certain conditions. On September 7, 2011, CoBank and U.S. AgBank stockholders approved the merger transaction. Final approval from the FCA is expected during the fourth quarter of 2011, and the banks plan to formally merge on January 1, 2012.

The merged bank will continue to do business under the CoBank name and be headquartered in Colorado, but it will maintain U.S. AgBank's existing presence and operations in Wichita, Kansas, and Sacramento, California. Robert B. Engel, CoBank's president and chief executive officer, will be the chief executive of the combined entity. U.S. AgBank had total assets of \$24.5 billion and capital of \$1.3 billion at September 30, 2011.

We believe the merger will create significant benefits for the combined bank and its customer-owners. Full details about the transaction were provided in disclosure materials sent to stockholders in July 2011. Information and announcements about the merger are also available at the CoBank website or at www.usagbankcobankmerger.com.

Downgrade of the Long-Term U.S. Sovereign Credit Rating and the System's Long-Term Debt Rating

The System is a government sponsored enterprise, and CoBank, as a member of the System, has historically benefited from the highly liquid, competitively priced debt funding available to us through the issuance of Systemwide debt securities. In August 2011, Standard & Poor's Ratings Services (S&P) downgraded the long-term sovereign credit rating of the U.S. from AAA to AA+ with a negative outlook. The credit ratings of government sponsored enterprises, including the System, are influenced by the sovereign credit rating of the U.S. As a result, S&P also lowered its long-term debt rating of the System from AAA to AA+. The ratings of individual System Banks rated by S&P, including CoBank, were not affected. The other two major rating agencies, Moody's Investors Service (Moody's) and Fitch Ratings (Fitch), have affirmed the AAA sovereign credit rating of the U.S. and the AAA rating of the System. However, Moody's has assigned a negative outlook to the U.S. rating. Notwithstanding these actions, to date we have continued to access the funding necessary to support our lending and business operations. However, such actions and any future downgrades could negatively impact funding costs, earnings and funding flexibility for CoBank and other System institutions.

Business Outlook

Our Board of Directors and management are committed to continuing our strong financial and operating performance and to fulfilling our mission to serve as a dependable provider of credit and other financial services to vital industries across rural America.

Our continued success will be achieved by delivering on our value proposition, creating opportunities to partner with other System institutions, increasing market share, maintaining effective access to the agency debt capital markets, optimizing current lending authorities and pursuing various strategic alliances with other financial services organizations.

Slow global economic growth is a concern for CoBank and its customers. Customers in certain of the industries we serve continue to feel the impact of unpredictable and volatile agricultural commodity prices, a continued weak housing market, and regulatory and political uncertainty. These challenges could reduce the credit quality and level of loan demand in certain sectors of our lending portfolio. Continued weakness in the housing market and/or persistently high unemployment could also lead to further losses on our non-agency investment securities. Greater liquidity in debt funding markets and a renewed focus by banks on commercial lending continues to increase competition across many of the sectors we serve. In addition, the lower level of medium-term interest rates negatively impacts the return on our invested capital.

Despite these and other challenges, we are well capitalized and our liquidity position remains strong. We will continue our disciplined approach to managing risk and will closely monitor asset quality while emphasizing effective enterprise-wide risk management. We will also continue to enhance our financial condition through prudent expense discipline and the retention of a portion of our earnings.

We believe CoBank continues to experience significant opportunities across all the industries we serve. Under the guidance of our Board of Directors and through the focus of a proven executive management team, we look forward to continuing to deliver on our value proposition on behalf of our customers and to fulfilling our mission as a dependable and strategic source of credit and financial services to the nation's rural economy.

Forward-Looking Statements

Certain of the statements contained in this quarterly report that are not historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act. Our actual results may differ materially from those included in the forward-looking statements that relate to our plans, projections, expectations and intentions. Forward-looking statements are typically identified by words such as “believe,” “expect,” “anticipate,” “intend,” “estimate,” “plan,” “project,” “may,” “will,” “should,” “would,” “could” or similar expressions. Although we believe that the information expressed or implied in such forward-looking statements is reasonable, we can give no assurance that such projections and expectations will be realized or the extent to which a particular plan, projection or expectation may be realized. These forward-looking statements are based on current knowledge and are subject to various risks and uncertainties, including, but not limited to:

- Potential deterioration in the agricultural, energy, communications, water, and leasing sectors;
- Weak U.S. and global economic conditions;
- Legislative and regulatory actions;
- Government policies and developments in the U.S. and other countries in which we make loans;
- The effect of banking and financial services reforms;
- Possible amendments to, and interpretations of, risk-based capital guidelines;
- Environmental-related conditions or laws impacting our lending activities;
- Changes in the U.S. government’s support of the agriculture industry;
- Actions taken by the U.S. Congress relative to Government Sponsored Enterprises (GSEs), including the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Agricultural Mortgage Corporation (Farmer Mac);
- Actions taken by the U.S. government to manage fiscal policy;
- Actions taken by the Federal Reserve to manage the monetary policy of the U.S.;
- A decrease in the credit outlook or ratings of U.S. government debt and agency debt, including Farm Credit System debt securities;
- The level of interest rates;
- Relationships between various interest rate indices;
- Changes in assumptions underlying the valuations of financial instruments;
- Changes in the bases for our estimates underlying the reserve for credit exposure;
- Credit performance of the loan portfolios, portfolio growth and seasonal factors;
- Failure of our investment portfolio to perform as expected or deterioration in the credit quality of such investments;
- The resolution of legal proceedings and related matters;
- Weather-related, disease and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- Nonperformance by counterparties to our derivative positions; and
- Our ability to successfully complete, integrate and profitably operate any business combinations or strategic alliances, including the proposed merger discussed on page 12.

We expressly disclaim any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

Condensed Consolidated Statements of Income

CoBank, ACB

(\$ in Thousands) (Unaudited)

| | For the Three Months | | For the Nine Months | |
|--|----------------------|------------|---------------------|--------------|
| | Ended September 30, | | Ended September 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| Interest Income | | | | |
| Loans | \$ 360,342 | \$ 344,114 | \$ 1,169,303 | \$ 1,016,546 |
| Investment Securities | 67,213 | 63,334 | 204,479 | 196,271 |
| Total Interest Income | 427,555 | 407,448 | 1,373,782 | 1,212,817 |
| Interest Expense | 175,560 | 181,172 | 544,046 | 537,918 |
| Net Interest Income | 251,995 | 226,276 | 829,736 | 674,899 |
| Provision for Loan Losses | 12,500 | 21,000 | 50,000 | 37,500 |
| Net Interest Income After Provision for Loan Losses | 239,495 | 205,276 | 779,736 | 637,399 |
| Noninterest Income/ Expense | | | | |
| Net Fee Income | 32,689 | 24,902 | 82,556 | 71,389 |
| Prepayment Income | 5,360 | 5,033 | 16,851 | 8,877 |
| Losses on Early Extinguishments of Debt | (18,147) | (4,979) | (26,923) | (8,746) |
| Total Other-Than-Temporary Impairment Losses | - | (45,052) | (2,847) | (49,851) |
| Portion of Loss Recognized in Other Comprehensive Loss | (2,000) | 20,052 | (3,153) | 10,851 |
| Net Other-Than-Temporary Impairment Losses | | | | |
| Included in Earnings | (2,000) | (25,000) | (6,000) | (39,000) |
| Other, Net | 10,360 | 3,352 | 25,966 | 45,906 |
| Total Noninterest Income | 28,262 | 3,308 | 92,450 | 78,426 |
| Operating Expenses | | | | |
| Employee Compensation | 28,655 | 24,481 | 85,426 | 71,355 |
| Insurance Fund Premium | 4,721 | 3,225 | 15,753 | 9,351 |
| Information Services | 4,077 | 3,957 | 11,924 | 11,290 |
| General and Administrative | 7,121 | 4,009 | 18,164 | 34,477 |
| Occupancy and Equipment | 1,779 | 1,594 | 5,044 | 4,788 |
| Farm Credit System Related | 1,801 | 1,833 | 5,472 | 5,370 |
| Purchased Services | 4,827 | 1,625 | 14,132 | 8,249 |
| Other | 3,153 | 2,563 | 9,620 | 8,231 |
| Total Operating Expenses | 56,134 | 43,287 | 165,535 | 153,111 |
| Income Before Income Taxes | 211,623 | 165,297 | 706,651 | 562,714 |
| Provision for Income Taxes | 41,706 | 33,339 | 143,945 | 111,725 |
| Net Income | \$ 169,917 | \$ 131,958 | \$ 562,706 | \$ 450,989 |

The accompanying notes are an integral part of the condensed consolidated financial statements.

Condensed Consolidated Balance Sheets

CoBank, ACB

(\$ in Thousands)

| | September 30, 2011 (Unaudited) | December 31, 2010 |
|---|-----------------------------------|----------------------|
| Assets | | |
| Total Loans | \$ 45,027,900 | \$ 49,992,338 |
| Less: Allowance for Loan Losses | 390,813 | 400,744 |
| Net Loans | 44,637,087 | 49,591,594 |
| Cash | 2,778,396 | 1,922,586 |
| Investment Securities | 13,237,173 | 12,616,696 |
| Interest Rate Swaps and Other Financial Instruments | 1,114,987 | 1,001,365 |
| Accrued Interest Receivable and Other Assets | 568,186 | 693,649 |
| Total Assets | \$ 62,335,829 | \$ 65,825,890 |
| Liabilities | | |
| Bonds and Notes | \$ 55,294,927 | \$ 59,324,313 |
| Subordinated Debt | 1,000,000 | 1,000,000 |
| Interest Rate Swaps and Other Financial Instruments | 130,242 | 92,580 |
| Reserve for Unfunded Commitments | 142,591 | 99,799 |
| Accrued Interest Payable and Other Liabilities | 912,814 | 903,001 |
| Total Liabilities | 57,480,574 | 61,419,693 |
| Commitments and Contingent Liabilities (Note 7) | | |
| Shareholders' Equity | | |
| Preferred Stock | 700,000 | 700,000 |
| Common Stock | 1,623,225 | 1,568,989 |
| Unallocated Retained Earnings | 2,392,015 | 2,137,394 |
| Accumulated Other Comprehensive Income (Loss) | 140,015 | (186) |
| Total Shareholders' Equity | 4,855,255 | 4,406,197 |
| Total Liabilities and Shareholders' Equity | \$ 62,335,829 | \$ 65,825,890 |

The accompanying notes are an integral part of the condensed consolidated financial statements.

Condensed Consolidated Statements of Cash Flows

CoBank, ACB

(\$ in Thousands) (Unaudited)

| For the Nine Months Ended September 30, | 2011 | 2010 |
|---|---------------------|---------------------|
| Cash Flows Provided by Operating Activities | | |
| Net Income | \$ 562,706 | \$ 450,989 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: | | |
| Provision for Loan Losses | 50,000 | 37,500 |
| Deferred Income Taxes | (17,337) | (22,620) |
| Depreciation and Amortization/Accretion, Net | 8,167 | 2,509 |
| Losses on Impairment of Available-for-Sale Investments | 6,000 | 39,000 |
| Net Gain on Sale of Investment Securities | (4,451) | - |
| Decrease (Increase) in Accrued Interest Receivable and Other Assets | 133,745 | (52,558) |
| Decrease in Accrued Interest Payable and Other Liabilities | (37,753) | (100,855) |
| Net (Gains) Losses on Interest Rate Swaps and Other Financial Instruments | (6,641) | 400 |
| Proceeds from Termination of Interest Rate Swaps | 28,205 | - |
| Other | (1,787) | (7,316) |
| Net Cash Provided by Operating Activities | 720,854 | 347,049 |
| Cash Flows Provided by (Used in) Investing Activities | | |
| Net Decrease (Increase) in Loans | 4,935,387 | (2,324,398) |
| Net (Increase) Decrease in Investment Securities | (396,653) | 1,387,835 |
| Net Cash Provided by (Used in) Investing Activities | 4,538,734 | (936,563) |
| Cash Flows Provided by (Used in) Financing Activities | | |
| Net (Retirements) Issuances of Bonds and Notes | (4,131,376) | 993,537 |
| Net Retirements of Common Stock | (29,833) | (43,890) |
| Cash Patronage Distribution Paid | (194,720) | (185,940) |
| Preferred Stock Dividends Paid | (47,849) | (47,849) |
| Net Cash Provided by (Used in) Financing Activities | (4,403,778) | 715,858 |
| Net Increase in Cash | 855,810 | 126,344 |
| Cash at Beginning of Period | 1,922,586 | 923,083 |
| Cash at End of Period | \$ 2,778,396 | \$ 1,049,427 |
| Supplemental Disclosures: | | |
| Schedule of Noncash Investing and Financing Activities | | |
| Net Change in Accrued Securities Purchases | \$ - | \$ (542,920) |
| Net Change in Unrealized Losses/Gains on Investment Securities, Before Taxes | 225,434 | 160,465 |
| Net Change in Unrealized Losses/Gains on Interest Rate Swaps, Other Financial Instruments and Hedged Items, Before Taxes | (1,776) | (8,207) |
| Patronage in Common Stock | 84,069 | 65,228 |

The accompanying notes are an integral part of the condensed consolidated financial statements.

Condensed Consolidated Statements of Changes in Shareholders' Equity

CoBank, ACB

(\$ in Thousands) (Unaudited)

| For the Nine Months Ended September 30, | 2011 | 2010 |
|--|---------------------|---------------------|
| Balance at Beginning of Period | \$ 4,406,197 | \$ 4,057,629 |
| Comprehensive Income: | | |
| Net Income | 562,706 | 450,989 |
| Other Comprehensive Income, Net of Taxes: | | |
| Net Change in Unrealized Losses/Gains on Investment Securities Not Other-Than-Temporarily Impaired | 135,472 | 106,147 |
| Other-Than-Temporarily Impaired Investment Securities | 4,297 | (6,659) |
| Net Change in Unrealized Losses/Gains on Interest Rate Swaps and Other Financial Instruments | (1,101) | (5,088) |
| Net Pension Adjustment | 1,533 | 753 |
| Comprehensive Income | 702,907 | 546,142 |
| Preferred Stock Dividends | (47,849) | (47,849) |
| Common Stock Issued | 67 | 90 |
| Common Stock Retired | (29,900) | (43,980) |
| Cash Patronage Accrued | (176,167) | (140,656) |
| Balance at End of Period | \$ 4,855,255 | \$ 4,371,376 |

The accompanying notes are an integral part of the condensed consolidated financial statements.

Notes to Condensed Consolidated Financial Statements

CoBank, ACB

(Unaudited) (\$ in Thousands, Except as Noted)

Note 1 – Organization, Lending Authority and Significant Accounting Policies

The accompanying condensed consolidated financial statements include the accounts of CoBank, ACB and its wholly-owned subsidiary, Farm Credit Leasing Services Corporation (FCL), collectively hereinafter referred to as CoBank or the Bank. All material inter-company accounts and transactions have been eliminated. In our opinion, all adjustments considered necessary for a fair presentation of the interim financial condition, results of operations and cash flows have been made. These adjustments are of a normal recurring nature, unless otherwise disclosed. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. Our results of operations for the nine months ended September 30, 2011 are not necessarily indicative of results to be expected for the entire fiscal year.

The accompanying condensed consolidated financial statements exclude financial information of Northwest Farm Credit Services, ACA (Northwest) as well as the Farm Credit System (System) Associations in the Northeastern region of the United States (Northeast Associations), which are collectively referred to as our affiliated Associations. CoBank and our affiliated Associations are collectively referred to as the “District.” The supplemental information on pages 40 and 41 includes certain combined financial information of our affiliated Associations and the District.

Copies of CoBank’s financial reports are available on request by calling or visiting one of our banking center locations and through our website at www.cobank.com. Copies of financial reports of our affiliated Associations and the System are available on their respective websites.

These unaudited quarterly condensed consolidated financial statements should be read in conjunction with the 2010 Annual Report, which includes a description of our organization and lending authority. Also included in the 2010 Annual Report is a summary of significant accounting policies. These quarterly condensed consolidated financial statements have been prepared in accordance with these same accounting policies. Certain reclassifications have been made to amounts reported in the prior period to conform to the current period presentation.

We have evaluated subsequent events through November 9, 2011, which is the date the financial statements were issued.

Note 2 – Loans, Loan Quality and Reserve for Credit Exposure

Loans Outstanding

Loans outstanding by operating segment are shown below.

(\$ in Millions)

| | September 30, 2011 | December 31, 2010 |
|-------------------------|--------------------|-------------------|
| Agribusiness | \$ 17,876 | \$ 22,676 |
| Strategic Relationships | 15,193 | 15,392 |
| Rural Infrastructure | 11,959 | 11,924 |
| Total | \$ 45,028 | \$ 49,992 |

Reserve for Credit Exposure

The following tables present the changes in the components of our reserve for credit exposure and details of ending balances. The reserve for credit exposure includes the allowance for loan losses and the reserve for unfunded commitments. The elements of our reserve for credit exposure are presented by operating segment.

| | Agribusiness | Strategic Relationships ⁽¹⁾ | Rural Infrastructure | Total |
|---|----------------------|--|----------------------|----------------------|
| September 30, 2011 | | | | |
| Allowance for Loan Losses | | | | |
| Beginning Balance | \$ 284,217 | \$ - | \$ 116,527 | \$ 400,744 |
| Charge-offs | (9,088) | - | (10,772) | (19,860) |
| Recoveries | 2,454 | - | 267 | 2,721 |
| Provision for Loan Losses | 39,500 | - | 10,500 | 50,000 |
| Transfers to Reserve for Unfunded Commitments | (36,126) | - | (6,666) | (42,792) |
| Ending Balance | 280,957 | - | 109,856 | 390,813 |
| Reserve for Unfunded Commitments | | | | |
| Beginning Balance | 68,599 | - | 31,200 | 99,799 |
| Transfers from Allowance for Loan Losses | 36,126 | - | 6,666 | 42,792 |
| Ending Balance | 104,725 | - | 37,866 | 142,591 |
| Reserve for Credit Exposure | \$ 385,682 | \$ - | \$ 147,722 | \$ 533,404 |
| Reserve for Credit Exposure | | | | |
| Ending Balance, Reserve for Credit Exposure Related to Loans: | | | | |
| Individually Evaluated for Impairment | \$ 19,754 | \$ - | \$ 9,643 | \$ 29,397 |
| Collectively Evaluated for Impairment | 365,928 | - | 138,079 | 504,007 |
| Acquired with Deteriorated Credit Quality | - | - | - | - |
| Total | \$ 385,682 | \$ - | \$ 147,722 | \$ 533,404 |
| Loans | | | | |
| Ending Balance for Loans and Related Accrued Interest: | | | | |
| Individually Evaluated for Impairment | \$ 107,535 | \$ 15,235,633 | \$ 53,213 | \$ 15,396,381 |
| Collectively Evaluated for Impairment | 17,824,722 | - | 11,969,145 | 29,793,867 |
| Acquired with Deteriorated Credit Quality | - | - | - | - |
| Total | \$ 17,932,257 | \$ 15,235,633 | \$ 12,022,358 | \$ 45,190,248 |

| | Strategic | | Rural | | |
|---|---------------|------------------------------|----------------|----|------------|
| | Agribusiness | Relationships ⁽¹⁾ | Infrastructure | | Total |
| September 30, 2010 | | | | | |
| Allowance for Loan Losses | | | | | |
| Beginning Balance | \$ 264,540 | \$ - | \$ 105,277 | \$ | 369,817 |
| Charge-offs | (21,779) | - | (31,650) | | (53,429) |
| Recoveries | 3,055 | - | 12,182 | | 15,237 |
| Provision (Reversal) for Loan Losses | (7,000) | - | 44,500 | | 37,500 |
| Transfers to Reserve for Unfunded Commitments | (2,250) | - | (986) | | (3,236) |
| Ending Balance | 236,566 | - | 129,323 | | 365,889 |
| Reserve for Unfunded Commitments | | | | | |
| Beginning Balance | 102,768 | - | 25,605 | | 128,373 |
| Transfers from Allowance for Loan Losses | 2,250 | - | 986 | | 3,236 |
| Ending Balance | 105,018 | - | 26,591 | | 131,609 |
| Reserve for Credit Exposure | \$ 341,584 | \$ - | \$ 155,914 | \$ | 497,498 |
| Reserve for Credit Exposure | | | | | |
| Ending Balance, Reserve for Credit Exposure Related to Loans: | | | | | |
| Individually Evaluated for Impairment | \$ 17,805 | \$ - | \$ 37,500 | \$ | 55,305 |
| Collectively Evaluated for Impairment | 323,779 | - | 118,414 | | 442,193 |
| Acquired with Deteriorated Credit Quality | - | - | - | | - |
| Total | \$ 341,584 | \$ - | \$ 155,914 | \$ | 497,498 |
| Loans | | | | | |
| Ending Balance for Loans and Related Accrued Interest: | | | | | |
| Individually Evaluated for Impairment | \$ 186,169 | \$ 15,337,378 | \$ 54,248 | \$ | 15,577,795 |
| Collectively Evaluated for Impairment | 19,312,201 | - | 11,753,931 | | 31,066,132 |
| Acquired with Deteriorated Credit Quality | - | - | - | | - |
| Total | \$ 19,498,370 | \$ 15,337,378 | \$ 11,808,179 | \$ | 46,643,927 |

⁽¹⁾ As a result of our strong collateral position with respect to loans to Associations, along with the earnings, capital and loss reserves of Associations that serve as an additional layer of protection against losses, no reserve for credit exposure is recorded in our Strategic Relationships operating segment.

The information in the tables under the Credit Quality, Aging Analysis and Impaired Loans captions is presented by operating segment, with guaranteed and non-guaranteed loans in our Agribusiness segment separately identified.

Credit Quality

The following table presents our loans and related accrued interest classified, by management, pursuant to our regulator's Uniform Loan Classification System.

| | Agribusiness | | Strategic | | Rural | | |
|--------------------------|----------------|--------------|---------------|----------------|-------|------------|--|
| September 30, 2011 | Non-Guaranteed | Guaranteed | Relationships | Infrastructure | | Total | |
| Acceptable | \$ 13,190,052 | \$ 3,046,545 | \$ 14,685,300 | \$ 11,763,910 | \$ | 42,685,807 | |
| Special Mention | 1,133,135 | 40 | 550,333 | 158,064 | | 1,841,572 | |
| Substandard | 542,954 | - | - | 90,813 | | 633,767 | |
| Doubtful | 19,531 | - | - | 9,571 | | 29,102 | |
| Loss | - | - | - | - | | - | |
| Total | \$ 14,885,672 | \$ 3,046,585 | \$ 15,235,633 | \$ 12,022,358 | \$ | 45,190,248 | |
| December 31, 2010 | | | | | | | |
| Acceptable | \$ 17,577,545 | \$ 3,385,473 | \$ 14,885,307 | \$ 11,688,197 | \$ | 47,536,522 | |
| Special Mention | 1,192,436 | 208 | 399,787 | 177,407 | | 1,769,838 | |
| Substandard | 564,926 | 266 | 150,100 | 99,416 | | 814,708 | |
| Doubtful | 16,813 | - | - | 25,920 | | 42,733 | |
| Loss | - | - | - | - | | - | |
| Total | \$ 19,351,720 | \$ 3,385,947 | \$ 15,435,194 | \$ 11,990,940 | \$ | 50,163,801 | |

Aging Analysis

The following tables present an aging of past due loans and related accrued interest.

| September 30, 2011 | Agribusiness | | Strategic | | Rural | | Total |
|---|----------------------|---------------------|----------------------|----------------------|-------------|-------------|----------------------|
| | Non-Guaranteed | Guaranteed | Relationships | Infrastructure | | | |
| 30-89 Days Past Due | \$ 22,646 | \$ - | \$ - | \$ 2,071 | \$ - | \$ - | \$ 24,717 |
| 90 Days Past Due | 25,097 | - | - | - | - | - | 25,097 |
| Total Past Due | \$ 47,743 | \$ - | \$ - | \$ 2,071 | \$ - | \$ - | \$ 49,814 |
| Current | 14,837,929 | 3,046,585 | 15,235,633 | 12,020,287 | | | 45,140,434 |
| Total | \$ 14,885,672 | \$ 3,046,585 | \$ 15,235,633 | \$ 12,022,358 | \$ - | \$ - | \$ 45,190,248 |
| Accruing Loans 90 Days or More Past Due | \$ 114 | \$ - | \$ - | \$ - | \$ - | \$ - | 114 |
| December 31, 2010 | | | | | | | |
| 30-89 Days Past Due | \$ 8,606 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 8,606 |
| 90 Days Past Due | 5,664 | - | - | 33,716 | - | - | 39,380 |
| Total Past Due | \$ 14,270 | \$ - | \$ - | \$ 33,716 | \$ - | \$ - | \$ 47,986 |
| Current | 19,337,450 | 3,385,947 | 15,435,194 | 11,957,224 | | | 50,115,815 |
| Total | \$ 19,351,720 | \$ 3,385,947 | \$ 15,435,194 | \$ 11,990,940 | \$ - | \$ - | \$ 50,163,801 |
| Accruing Loans 90 Days or More Past Due | \$ 681 | \$ - | \$ - | \$ - | \$ - | \$ - | 681 |

Impaired Loans

Impaired loan information is shown in the following tables. Loans past due 90 days or more and still accruing interest are adequately secured and in the process of collection.

| September 30, 2011 | Agribusiness | | Strategic | | Rural | | Total |
|---|-------------------|---------------------------|------------------------------|------------------|-------------|-------------|-------------------|
| | Non-Guaranteed | Guaranteed ⁽¹⁾ | Relationships ⁽¹⁾ | Infrastructure | | | |
| Nonaccrual Loans | \$ 107,536 | \$ - | \$ - | \$ 53,213 | \$ - | \$ - | \$ 160,749 |
| Accruing Loans 90 Days or More Past Due | 114 | - | - | - | - | - | 114 |
| Restructured Loans | - | - | - | - | - | - | - |
| Total Impaired Loans | \$ 107,650 | \$ - | \$ - | \$ 53,213 | \$ - | \$ - | \$ 160,863 |
| December 31, 2010 | | | | | | | |
| Nonaccrual Loans | \$ 93,373 | \$ - | \$ - | \$ 73,600 | \$ - | \$ - | \$ 166,973 |
| Accruing Loans 90 Days or More Past Due | 681 | - | - | - | - | - | 681 |
| Restructured Loans | - | - | - | - | - | - | - |
| Total Impaired Loans | \$ 94,054 | \$ - | \$ - | \$ 73,600 | \$ - | \$ - | \$ 167,654 |

⁽¹⁾ There were no impaired loans in our Agribusiness Guaranteed or Strategic Relationships portfolios for any of the periods presented.

The following tables present information on impaired loans and related amounts in the allowance for loan losses.

| September 30, 2011 | Agribusiness Non-Guaranteed | Agribusiness Guaranteed ⁽¹⁾ | Strategic Relationships ⁽¹⁾ | Rural Infrastructure | Total |
|---|--------------------------------|---|---|-------------------------|-----------|
| Impaired Loans With No Related Allowance for Loan Losses | | | | | |
| Carrying Amount | \$ 31,176 | \$ - | \$ - | \$ 34,466 | \$ 65,642 |
| Unpaid Principal | 42,402 | - | - | 48,243 | 90,645 |
| Average Balance | 35,315 | - | - | 43,998 | 79,313 |
| Interest Income Recognized | 4,233 | - | - | 93 | 4,326 |
| Impaired Loans With Related Allowance for Loan Losses | | | | | |
| Carrying Amount | 76,474 | - | - | 18,747 | 95,221 |
| Unpaid Principal | 96,576 | - | - | 20,304 | 116,880 |
| Allowance for Loan Losses | 19,754 | - | - | 9,643 | 29,397 |
| Average Balance | 74,425 | - | - | 18,675 | 93,100 |
| Interest Income Recognized | 208 | - | - | - | 208 |
| Total Impaired Loans | | | | | |
| Carrying Amount | 107,650 | - | - | 53,213 | 160,863 |
| Unpaid Principal | 138,978 | - | - | 68,547 | 207,525 |
| Allowance for Loan Losses | 19,754 | - | - | 9,643 | 29,397 |
| Average Balance | 109,740 | - | - | 62,673 | 172,413 |
| Interest Income Recognized | 4,441 | - | - | 93 | 4,534 |

| December 31, 2010 | Agribusiness Non-Guaranteed | Agribusiness Guaranteed ⁽¹⁾ | Strategic Relationships ⁽¹⁾ | Rural Infrastructure | Total |
|---|--------------------------------|---|---|-------------------------|-----------|
| Impaired Loans With No Related Allowance for Loan Losses | | | | | |
| Carrying Amount | \$ 34,866 | \$ - | \$ - | \$ 20,952 | \$ 55,818 |
| Unpaid Principal | 47,004 | - | - | 39,939 | 86,943 |
| Average Balance | 106,480 | - | - | 28,357 | 134,837 |
| Interest Income Recognized | 4,405 | - | - | 1,059 | 5,464 |
| Impaired Loans With Related Allowance for Loan Losses | | | | | |
| Carrying Amount | 59,188 | - | - | 52,648 | 111,836 |
| Unpaid Principal | 76,519 | - | - | 65,223 | 141,742 |
| Allowance for Loan Losses | 16,918 | - | - | 23,200 | 40,118 |
| Average Balance | 65,001 | - | - | 61,777 | 126,778 |
| Interest Income Recognized | - | - | - | - | - |
| Total Impaired Loans | | | | | |
| Carrying Amount | 94,054 | - | - | 73,600 | 167,654 |
| Unpaid Principal | 123,523 | - | - | 105,162 | 228,685 |
| Allowance for Loan Losses | 16,918 | - | - | 23,200 | 40,118 |
| Average Balance | 171,481 | - | - | 90,134 | 261,615 |
| Interest Income Recognized | 4,405 | - | - | 1,059 | 5,464 |

⁽¹⁾ There were no impaired loans in our Agribusiness Guaranteed or Strategic Relationships portfolios for any of the periods presented.

There were \$12.8 million in commitments to extend additional credit to borrowers whose loans were classified as impaired at September 30, 2011.

Note 3 – Investment Securities

A summary of the amortized cost and fair value of investment securities available-for-sale is as follows:

(\$ in Millions)

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|-------------------------------|-------------------|------------------------------|-------------------------------|------------------|
| September 30, 2011 | | | | |
| U.S. Treasury and Agency Debt | \$ 3,789 | \$ 87 | \$ - | \$ 3,876 |
| Mortgage-Backed: | | | | |
| U.S. Agency | 8,777 | 243 | (4) | 9,016 |
| Non-Agency | 297 | 2 | (20) | 279 |
| Asset-Backed | 83 | - | (17) | 66 |
| Total | \$ 12,946 | \$ 332 | \$ (41) | \$ 13,237 |

(\$ in Millions)

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|-------------------------------|-------------------|------------------------------|-------------------------------|------------------|
| December 31, 2010 | | | | |
| U.S. Treasury and Agency Debt | \$ 3,311 | \$ 47 | \$ - | \$ 3,358 |
| Mortgage-Backed: | | | | |
| U.S. Agency | 8,673 | 124 | (58) | 8,739 |
| Non-Agency | 424 | 2 | (24) | 402 |
| Asset-Backed | 143 | - | (25) | 118 |
| Total | \$ 12,551 | \$ 173 | \$ (107) | \$ 12,617 |

A summary of the contractual maturity, amortized cost, fair value and weighted average yield of investment securities by type at September 30, 2011 is as follows:

U.S. Treasury and Agency Debt Securities

| (\$ in Millions) | Amortized Cost | Fair Value | Weighted Average Yield |
|---------------------|-------------------|-----------------|---------------------------|
| In One Year or Less | \$ 2,033 | \$ 2,036 | 0.72 % |
| One to Five Years | 1,256 | 1,265 | 1.30 |
| Five to Ten Years | 500 | 575 | 4.11 |
| After Ten Years | - | - | - |
| Total | \$ 3,789 | \$ 3,876 | 1.30 |

U.S. Agency Mortgage-Backed Securities

| (\$ in Millions) | Amortized Cost | Fair Value | Weighted Average Yield |
|---------------------|-------------------|-----------------|---------------------------|
| In One Year or Less | \$ - | \$ - | - % |
| One to Five Years | 96 | 96 | 2.12 |
| Five to Ten Years | 501 | 514 | 3.44 |
| After Ten Years | 8,180 | 8,406 | 2.19 |
| Total | \$ 8,777 | \$ 9,016 | 2.26 |

Non-Agency Mortgage-Backed Securities

| (\$ in Millions) | Amortized Cost | Fair Value | Weighted Average Yield |
|---------------------|----------------|---------------|------------------------|
| In One Year or Less | \$ - | \$ - | - % |
| One to Five Years | - | - | - |
| Five to Ten Years | 23 | 22 | 0.70 |
| After Ten Years | 274 | 257 | 3.75 |
| Total | \$ 297 | \$ 279 | 3.53 |

Asset-Backed Securities

| (\$ in Millions) | Amortized Cost | Fair Value | Weighted Average Yield |
|---------------------|----------------|--------------|------------------------|
| In One Year or Less | \$ - | \$ - | - % |
| One to Five Years | - | - | - |
| Five to Ten Years | - | - | - |
| After Ten Years | 83 | 66 | 4.24 |
| Total | \$ 83 | \$ 66 | 4.24 |

While the substantial majority of our mortgage-backed and all of our asset-backed securities have contractual maturities in excess of 10 years, expected maturities for these securities are shorter than contractual maturities because borrowers have the right to call or prepay obligations with or without penalties.

The following tables show the fair value and gross unrealized losses for investments in a loss position aggregated by investment category, and the length of time the securities have been in a continuous unrealized loss position at September 30, 2011 and December 31, 2010. The continuous loss position is based on the date the impairment first occurred. Unrealized loss positions related to these securities, including those impaired for longer than 12 months, resulted primarily from widened credit spreads and decreased liquidity in the broader financial markets.

| (\$ in Millions) | Less Than 12 Months | | Greater Than 12 Months | |
|-------------------------------|---------------------|-------------------|------------------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| September 30, 2011 | | | | |
| U.S. Treasury and Agency Debt | \$ - | \$ - | \$ - | \$ - |
| Mortgage-Backed: | | | | |
| U.S. Agency | 749 | (2) | 561 | (2) |
| Non-Agency | 28 | (1) | 182 | (19) |
| Asset-Backed | - | - | 67 | (17) |
| Total | \$ 777 | \$ (3) | \$ 810 | \$ (38) |
| December 31, 2010 | | | | |
| U.S. Treasury and Agency Debt | \$ - | \$ - | \$ - | \$ - |
| Mortgage-Backed: | | | | |
| U.S. Agency | 3,188 | (56) | 641 | (2) |
| Non-Agency | - | - | 315 | (24) |
| Asset-Backed | - | - | 115 | (25) |
| Total | \$ 3,188 | \$ (56) | \$ 1,071 | \$ (51) |

As of September 30, 2011, with the exception of our other-than-temporary impaired (OTTI) securities discussed below, we expect to collect all principal and interest payments on our investment securities. We do not intend to sell the securities in unrealized loss positions, and it is not likely that we will be required to sell such securities, for regulatory, liquidity or other purposes, before an anticipated recovery of our cost basis occurs.

During the nine months ended September 30, 2011, we recorded \$6.0 million in impairment losses in earnings related to six securities compared to \$39.0 million in impairment losses related to 10 securities in the same period of 2010. As of September 30, 2011, we had 10 OTTI investment securities with a total fair value of \$150.0 million, compared to 10 OTTI investment securities with a total fair value of \$184.3 million at December 31, 2010. During the nine months ended September 30, 2011, we sold one OTTI investment security for proceeds of \$41.3 million and recorded a gain on disposition of \$4.5 million.

The following table details the activity related to the credit loss component of investment securities that have been written down for other-than-temporary impairment.

| Credit Losses on Impaired Investments | (\$ in Millions) |
|--|------------------|
| Balance at December 31, 2010 | \$ 59 |
| Additional Credit Impairments Related to Securities Impaired as of December 31, 2010 | 4 |
| Initial Credit Impairments Related to Securities Not Previously Impaired | 2 |
| Sales of Investments with Credit Impairments ⁽¹⁾ | (20) |
| Maturity of Investments with Credit Impairments | (1) |
| Subsequent Amortization (Accretion) for Increases in Cash Flows Expected to be Collected | 1 |
| Balance at September 30, 2011 | \$ 45 |

⁽¹⁾ During the nine months ended September 30, 2011, we sold one security for proceeds of \$41.3 million and recorded a gain on disposition of \$4.5 million. We had previously recorded impairment losses of \$20.2 million on this security.

For impaired investment securities, we estimate the component of unrealized losses attributable to credit losses using a third-party cash flow model. The model requires key assumptions related to underlying collateral, including the degree and timing of prepayments and defaults, and loss severity. Assumptions used are influenced by such factors as interest rates and the performance, type and age of collateral. For prepayment assumptions, we use the lower of the three- or six-month historical voluntary prepayment rate. Prepayment rates used ranged from 3 percent to 16 percent for impaired investment securities at September 30, 2011. We apply historical performance information to estimate future defaults using a default timing curve. Lifetime default rates ranged from 9 percent to 37 percent for impaired investment securities at September 30, 2011. Loss severity assumptions are based on actual performance, where available, or are obtained from an independent third-party. Loss severity ranged from 28 percent to 100 percent for impaired investment securities at September 30, 2011.

Note 4 – Derivative Financial Instruments and Hedging Activities

Risk Management Objectives and Strategies

We maintain an overall interest rate risk management strategy that incorporates the use of derivative financial instruments to manage liquidity and to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. Our goal is to manage interest rate sensitivity by modifying the repricing frequency or effective maturity of certain balance sheet assets and liabilities. We also maintain a foreign exchange risk management strategy to reduce the impact of currency fluctuations on our relatively nominal amount of foreign currency-denominated loans. As a result of interest rate and foreign exchange rate fluctuations, fixed-rate assets and liabilities will appreciate or depreciate in market value. The effect of this unrealized appreciation or depreciation is expected to be substantially offset by gains and losses on the

derivative instruments that are linked to these assets and liabilities. Interest rate and foreign exchange fluctuations also cause interest income and interest expense of variable-rate assets and liabilities to increase or decrease. The effect of this variability in earnings is expected to be substantially offset by gains and losses on the derivative instruments that are linked to these assets and liabilities.

Uses of Derivatives

To achieve risk management objectives and satisfy the financing needs of our borrowers, we execute various derivative transactions with other financial institutions. Derivatives (primarily interest rate swaps) are used to manage liquidity and the interest rate risk arising from maturity and repricing mismatches between assets and liabilities. Under interest rate swap arrangements, we agree with a third-party to exchange, at specified intervals, payment streams calculated on a specified notional amount, with at least one payment stream based on a specified floating-rate index. We use a variety of interest rate swaps including the exchange of floating-rate for fixed-rate swaps and fixed-rate for floating-rate swaps with payment obligations tied to specific indices. In addition, we execute foreign exchange spot and forward contracts to manage currency risk on loans denominated in foreign currencies. We also enter into derivatives for our customers as a service to enable them to transfer, modify or reduce their interest rate risk and foreign exchange risk by transferring such risk to us. We substantially offset this risk transference by concurrently entering into offsetting agreements with counterparties.

The notional amounts of derivatives at September 30, 2011 and related activity for the first nine months of 2011 are shown in the following table.

| Activity in the Notional Amounts of Derivative Financial Instruments | | | | | |
|---|------------------|-----------------|-----------------------|------------------|--|
| (\$ in Millions) | Swaps | Caps | Spots and Forwards | Total | |
| December 31, 2010 | \$ 28,699 | \$ 2,056 | \$ 199 | \$ 30,954 | |
| Additions /Accretion | 4,418 | - | 4,616 | 9,034 | |
| Maturities /Amortization | (7,202) | (38) | (4,489) | (11,729) | |
| Terminations | (1,373) | (19) | - | (1,392) | |
| September 30, 2011 | \$ 24,542 | \$ 1,999 | \$ 326 | \$ 26,867 | |

Accounting for Derivative Instruments and Hedging Activities

We record derivatives as assets or liabilities at their fair value on the consolidated balance sheets. We record changes in the fair value of a derivative in current period earnings or accumulated other comprehensive income (loss), depending on the use of the derivative and whether it qualifies for hedge accounting. For fair-value hedge transactions that hedge changes in the fair value of assets or liabilities, changes in the fair value of the derivative will generally be offset in the income statement by changes in the hedged item's fair value attributable to the risk being hedged. For cash-flow hedge transactions, in which we hedge the variability of future cash flows related to a variable-rate asset or liability, changes in the fair value of the derivative are reported in accumulated other comprehensive income (loss). The gains and losses on the derivatives that we report in accumulated other comprehensive income (loss) will be reclassified as earnings in the periods in which earnings are affected by the variability of the cash flows of the hedged item. We record the ineffective portion of all hedges in current period earnings.

For our customer transactions, which are not designated as hedging instruments, we record the related changes in fair value in current period earnings. We substantially offset this risk transference by concurrently entering into offsetting agreements with counterparties, with the changes in fair value of these transactions also recorded in current period earnings.

Fair Value Hedges

The majority of the fair value hedging activity relates to entering into interest rate swaps primarily to convert our non-prepayable fixed-rate debt to floating-rate debt to achieve our liquidity management strategy. The amount converted depends on contractual interest rates and maturities. For the remaining fair value hedges, we enter into receive-fixed, pay-floating swaps to align our equity positioning strategy with our risk management strategy. For fair value hedges, the amount of hedge ineffectiveness is recognized as net interest income in current period earnings.

Cash Flow Hedges

We purchase interest rate caps to hedge cap risk embedded within a portion of our floating-rate investment securities. The interest rate caps hedge floating-rate debt cash flows that fund the cash flows from floating-rate investment securities. If the strike rates in the purchased interest rate caps are exceeded, we receive cash flows on the derivative to hedge our floating-rate funding exposure above such strike levels. We also enter into foreign exchange spot and forward contracts to manage currency risk on loans denominated in foreign currencies. Typically, foreign currency contracts are purchased to fund the principal cash flows of the loan and simultaneously sold to lock in the principal and interest cash flows upon repricing or maturity date of the loan. For cash flow hedges, the amount of hedge ineffectiveness, the amount excluded from effectiveness assessment, and the amounts reclassified from accumulated other comprehensive income (loss) into current period earnings are all reflected in net interest income. At September 30, 2011, we expect that \$1.8 million of expense will be reclassified from other comprehensive income into the income statement in the next 12 months, based on the anticipated cash flows of existing financial instruments. The maximum term over which we are hedging our exposure to the variability of future cash flows for all forecasted transactions is approximately six years.

Derivatives Not Designated as Hedges

Derivative agreements with our customers and the related offsetting derivative agreements with counterparties are not designated as hedging instruments and do not receive hedge accounting treatment. Accordingly, any changes in the fair value of these customer related derivatives are recognized immediately as noninterest income/expense in current period earnings.

Counterparty Credit Risk

The use of derivatives for risk management introduces credit risk related to counterparties and market risk related to movements in interest rates. Generally, when the fair value of a derivative contract is positive, the counterparty owes us, thus creating a performance risk. When the fair value of the derivative contract is negative, we owe the counterparty, and therefore assume no performance risk.

To minimize the risk of credit losses, all derivative transactions are governed by master swap agreements, which include netting agreements requiring the net settlement of covered contracts with the same counterparty in the event of default by the other party. The “net” mark-to-market exposure represents the netting of the positive and negative exposures with that counterparty. The master swap agreements also include bilateral collateral arrangements, requiring the Bank or our counterparties to post collateral on a daily basis with thresholds set at zero for all active dealer counterparties. However, we are exposed to intra-day credit risk with these counterparties. Derivative transactions with our customers are secured through our loan agreements. We record derivative exposures and related cash collateral balances at gross amounts in our consolidated balance sheets. As of September 30, 2011, our counterparties had posted a net \$903.6 million in cash and \$79.7 million in securities as collateral with us. At September 30, 2011, a parallel increase of 2.0 percentage points in the USD LIBOR/swap curve would have required us to return substantially all of the collateral currently posted with us by our counterparties. The maximum amount of losses we could be exposed to in the event of nonperformance by dealer counterparties to our derivative positions, net of collateral held by us, was \$5.4 million at September 30, 2011.

Hedge Terminations

During the nine months ended September 30, 2011, we terminated approximately \$1.2 billion in notional value of interest rate swaps for asset-liability management purposes. These swaps had been accounted for as fair value hedges. We received proceeds of \$28.2 million as a result of the hedge contract terminations, which are reflected under operating activities in the condensed consolidated statement of cash flows. The previous fair value adjustments to the fixed rate debt that was hedged by these contracts will be amortized over the remaining life of the debt. During the nine months ended September 30, 2011, we also terminated interest rate swaps with customers and offsetting dealer counterparties totaling notional value of \$0.2 billion. Proceeds from the customer terminations were offset by proceeds from the offsetting dealer terminations.

A summary of the impact of derivative financial instruments on our consolidated balance sheets as of September 30, 2011 and December 31, 2010 is shown below.

Fair Value of Derivative Financial Instruments

| | Fair Value of Derivative Assets ⁽¹⁾ | Fair Value of Derivative Liabilities ⁽²⁾ |
|--|--|---|
| As of September 30, 2011 | | |
| Derivatives Designated as Hedging Instruments | | |
| Interest Rate Contracts | \$ 954,102 | \$ - |
| Foreign Exchange Contracts | 12,652 | 1 |
| Total Derivatives Designated as Hedging Instruments | \$ 966,754 | \$ 1 |
| Derivatives Not Designated as Hedging Instruments | | |
| Interest Rate Contracts | \$ 145,332 | \$ 127,539 |
| Foreign Exchange Contracts | 2,901 | 2,702 |
| Total Derivatives Not Designated as Hedging Instruments | \$ 148,233 | \$ 130,241 |
| Total Derivatives | \$ 1,114,987 | \$ 130,242 |

⁽¹⁾ These assets make up the "Interest Rate Swaps and Other Financial Instruments" assets in the condensed consolidated balance sheet at September 30, 2011

⁽²⁾ These liabilities make up the "Interest Rate Swaps and Other Financial Instruments" liabilities in the condensed consolidated balance sheet at September 30, 2011

Fair Value of Derivative Financial Instruments

| | Fair Value of Derivative Assets ⁽¹⁾ | Fair Value of Derivative Liabilities ⁽²⁾ |
|--|--|---|
| As of December 31, 2010 | | |
| Derivatives Designated as Hedging Instruments | | |
| Interest Rate Contracts | \$ 917,346 | \$ 19,017 |
| Foreign Exchange Contracts | 566 | 1,838 |
| Total Derivatives Designated as Hedging Instruments | \$ 917,912 | \$ 20,855 |
| Derivatives Not Designated as Hedging Instruments | | |
| Interest Rate Contracts | \$ 80,433 | \$ 68,913 |
| Foreign Exchange Contracts | 3,020 | 2,812 |
| Total Derivatives Not Designated as Hedging Instruments | \$ 83,453 | \$ 71,725 |
| Total Derivatives | \$ 1,001,365 | \$ 92,580 |

⁽¹⁾ These assets make up the "Interest Rate Swaps and Other Financial Instruments" assets in the condensed consolidated balance sheet at December 31, 2010

⁽²⁾ These liabilities make up the "Interest Rate Swaps and Other Financial Instruments" liabilities in the condensed consolidated balance sheet at December 31, 2010

A summary of the impact of derivative financial instruments on our consolidated income statements for the nine months ended September 30, 2011 and 2010 is shown below.

Derivative Financial Instruments in Fair Value Hedging Relationships

| Nine Months Ended September 30, | Net Amount of Gain or (Loss) Recognized in Income on Derivative and Hedged Item ⁽¹⁾ | |
|---------------------------------|--|-----------------|
| | 2011 | 2010 |
| Interest Rate Contracts | \$ 2,115 | \$ 1,177 |
| Total | \$ 2,115 | \$ 1,177 |

⁽¹⁾ Located in Interest Expense in the condensed consolidated income statements for the nine months ended September 30, 2011 and 2010

Derivative Financial Instruments in Cash Flow Hedging Relationships

| Nine Months Ended September 30, 2011 | Amount of Gain or (Loss) Recognized in OCI on Derivative ⁽¹⁾ | Amount of Gain or (Loss) Reclassified from OCI to Income on Derivative ⁽¹⁾ | Amount of Gain or (Loss) Recognized in Income on Derivative ⁽²⁾ |
|--------------------------------------|---|---|--|
| | | | |
| Interest Rate Contracts | \$ (3,737) | \$ (1,737) ⁽³⁾ | \$ - |
| Foreign Exchange Contracts | 13,924 | 13,700 ^{(4) (5)} | (1,848) ⁽⁴⁾ |
| Total | \$ 10,187 | \$ 11,963 | \$ (1,848) |

⁽¹⁾ Effective portion

⁽²⁾ Ineffective portion and amount excluded from effectiveness assessment

⁽³⁾ Located in Interest Expense in the condensed consolidated income statement for the nine months ended September 30, 2011

⁽⁴⁾ Located in Interest Income – Loans in the condensed consolidated income statement for the nine months ended September 30, 2011

⁽⁵⁾ Fully offset by a \$13,700 loss on foreign currency denominated loans (hedged items) which is also located in Interest Income - Loans in the condensed consolidated income statement for the nine months ended September 30, 2011

Derivative Financial Instruments in Cash Flow Hedging Relationships

| Nine Months Ended September 30, 2010 | Amount of Gain or (Loss) Recognized in OCI on Derivative ⁽¹⁾ | Amount of Gain or (Loss) Reclassified from OCI to Income on Derivative ⁽¹⁾ | Amount of Gain or (Loss) Recognized in Income on Derivative ⁽²⁾ |
|--------------------------------------|---|---|--|
| | | | |
| Interest Rate Contracts | \$ (9,024) | \$ (920) ⁽³⁾ | \$ - |
| Foreign Exchange Contracts | (6,256) | (6,154) ^{(4) (5)} | (210) ⁽⁴⁾ |
| Total | \$ (15,280) | \$ (7,074) | \$ (210) |

⁽¹⁾ Effective portion

⁽²⁾ Ineffective portion and amount excluded from effectiveness assessment

⁽³⁾ Located in Interest Expense in the condensed consolidated income statement for the nine months ended September 30, 2010

⁽⁴⁾ Located in Interest Income – Loans in the condensed consolidated income statement for the nine months ended September 30, 2010

⁽⁵⁾ Fully offset by a \$6,154 gain on foreign currency denominated loans (hedged items) which is also located in Interest Income - Loans in the condensed consolidated income statement for the nine months ended September 30, 2010

Derivative Financial Instruments not Designated as Hedging Relationships

| | Net Amount of Gain or (Loss) Recognized in Income On Derivative ⁽¹⁾ | |
|---------------------------------|--|-----------------|
| Nine Months Ended September 30, | 2011 | 2010 |
| Interest Rate Contracts | \$ 6,272 | \$ (744) |
| Foreign Exchange Contracts | (9) | (12) |
| Total | \$ 6,263 | \$ (756) |

⁽¹⁾ Located in Other Noninterest Income / Expense in the condensed consolidated income statements for the nine months ended September 30, 2011 and 2010

Note 5 – Fair Value Measurements

The fair values of financial instruments represent the estimated amount to be received to sell an asset or paid to transfer or extinguish a liability (an exit price) in active markets among willing participants at the reporting date. The Financial Accounting Standards Board (FASB) has established a three-level fair value hierarchy aimed at maximizing the use of observable inputs – that is, inputs that reflect the assumptions market participants would use in pricing an asset or liability.

A description of the methods, assumptions and inputs to the valuation process used to determine or estimate the fair value of each class of financial instruments within the three-level hierarchy follows.

Level 1

Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Our Level 1 assets at September 30, 2011 consist of assets held in a trust fund related to deferred compensation, our supplemental executive retirement plan and our executive retirement plan. The trust fund includes investments in securities that are actively traded and have quoted net asset value prices that are directly observable in the marketplace.

Level 2

Level 2 inputs include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability. Our Level 2 assets and liabilities at September 30, 2011 include our derivative contracts, collateral balances related to derivative contracts and investment securities, excluding asset-backed securities.

The fair value of our derivative financial instruments is the estimated amount to be received to sell a derivative asset or paid to transfer or extinguish a derivative liability in active markets among willing participants at the reporting date. Estimated fair values are determined through internal market valuation models. These models use an income approach and incorporate benchmark interest rate curves (primarily the USD LIBOR/swap curve), volatilities, counterparty credit quality and other inputs that are observable directly or indirectly in the marketplace. We compare internally calculated derivative valuations to broker/dealer quotes to substantiate the results. The fair value of collateral assets and liabilities related to derivative contracts is their face value, plus accrued interest, as these instruments are cash balances; therefore, fair value approximates face value.

The fair value of the majority of our investment securities is determined by a third-party pricing service that uses valuation models to estimate current market prices. Inputs and assumptions related to these models are typically observable in the marketplace. Such models incorporate prepayment assumptions and underlying collateral information to generate cash flows that are discounted using appropriate benchmark interest rate curves and volatilities. These third-party valuation models also incorporate information regarding broker/dealer quotes, available trade information, historical cash flows, credit ratings, and other market information. Such valuations represent an estimated exit price, or price to be received by a seller in active markets to sell the investment securities to a willing participant. The estimated fair values of investment securities also appear in Note 3.

Level 3

Level 3 inputs are unobservable and supported by limited or no market activity. Our Level 3 assets at September 30, 2011 include our asset-backed investment securities which are not issued or guaranteed by the U.S. government or its agencies. Based on the lack of active trading volume and an orderly market for our asset-backed securities, we classified this portfolio as Level 3. Market values for such asset-backed securities are calculated internally using third-party models, with certain adjustments made in consideration of third-party pricing service results. Inputs into these valuation models include underlying collateral data and projected losses as well as information for prepayment speeds and discounting spreads. Due to the lack of marketplace information, the inputs into these valuation models primarily represent management assumptions, with some corroboration to market inputs.

Level 3 assets at September 30, 2011 also include \$56.7 million of loans originally measured at cost, which were written down to fair value as a result of impairment, and \$0.5 million of other property owned. The valuation of these assets requires a determination of the fair value of the underlying collateral, which may include the use of independent appraisals or other market-based information to develop a management estimate of fair value. As a result, these fair value measurements fall under Level 3 in the fair value hierarchy; however, they are excluded from the following tables because they are not measured on a recurring basis.

Our Level 3 liabilities at September 30, 2011 include standby letters of credit whose market value is internally calculated based on information that is not observable either directly or indirectly in the marketplace.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables present the assets and liabilities that are measured at fair value on a recurring basis at September 30, 2011 and December 31, 2010 for each of the fair value hierarchy levels.

| Assets and Liabilities Measured at Fair Value on a Recurring Basis | | | | |
|---|--------------|------------------|--------------|------------------|
| September 30, 2011 | | | | |
| (\$ in Millions) | Level 1 | Level 2 | Level 3 | Total |
| Assets | | | | |
| Investment Securities: | | | | |
| U.S. Treasury Debt | \$ - | \$ 1,514 | \$ - | \$ 1,514 |
| U.S. Agency Debt | - | 2,362 | - | 2,362 |
| U.S. Agency Mortgage-Backed | - | 9,016 | - | 9,016 |
| Non-Agency Mortgage-Backed | - | 279 | - | 279 |
| Asset-Backed | - | - | 66 | 66 |
| Interest Rate Swaps and Other Financial Instruments | - | 1,115 | - | 1,115 |
| Assets Held in Trust (included in Other Assets) | 35 | - | - | 35 |
| Collateral Assets (included in Other Assets) | - | 15 | - | 15 |
| Total Assets | \$ 35 | \$ 14,301 | \$ 66 | \$ 14,402 |
| Liabilities | | | | |
| Interest Rate Swaps and Other Financial Instruments | \$ - | \$ 130 | \$ - | \$ 130 |
| Collateral Liabilities (included in Bonds and Notes) | - | 919 | - | 919 |
| Standby Letters of Credit (included in Other Liabilities) | - | - | 10 | 10 |
| Total Liabilities | \$ - | \$ 1,049 | \$ 10 | \$ 1,059 |

| Assets and Liabilities Measured at Fair Value on a Recurring Basis | | | | |
|---|--------------|------------------|---------------|------------------|
| December 31, 2010 | | | | |
| (\$ in Millions) | Level 1 | Level 2 | Level 3 | Total |
| Assets | | | | |
| Investment Securities: | | | | |
| U.S. Treasury Debt | \$ - | \$ 854 | \$ - | \$ 854 |
| U.S. Agency Debt | - | 2,504 | - | 2,504 |
| U.S. Agency Mortgage-Backed | - | 8,739 | - | 8,739 |
| Non-Agency Mortgage-Backed | - | 402 | - | 402 |
| Asset-Backed | - | - | 118 | 118 |
| Interest Rate Swaps and Other Financial Instruments | - | 1,001 | - | 1,001 |
| Assets Held in Trust (included in Other Assets) | 34 | - | - | 34 |
| Collateral Assets (included in Other Assets) | - | 7 | - | 7 |
| Total Assets | \$ 34 | \$ 13,507 | \$ 118 | \$ 13,659 |
| Liabilities | | | | |
| Interest Rate Swaps and Other Financial Instruments | \$ - | \$ 93 | \$ - | \$ 93 |
| Collateral Liabilities (included in Bonds and Notes) | - | 891 | - | 891 |
| Standby Letters of Credit (included in Other Liabilities) | - | - | 11 | 11 |
| Total Liabilities | \$ - | \$ 984 | \$ 11 | \$ 995 |

The following table presents the changes in Level 3 assets and liabilities measured at fair value on a recurring basis.

| Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis | | | | |
|---|---|------|--|-----|
| | Asset-Backed Investment Securities | | Standby Letters of Credit | |
| (\$ in Millions) | | | | |
| Balance at December 31, 2010 | \$ | 118 | \$ | 11 |
| Total Gains or Losses (Realized/Unrealized): | | | | |
| Included in Other Noninterest Expense | | 2 | | - |
| Included in Other Comprehensive Loss | | 8 | | - |
| Purchases | | - | | - |
| Sales | | (41) | | - |
| Issuances | | - | | 5 |
| Settlements | | (21) | | (6) |
| Balance at September 30, 2011 | \$ | 66 | \$ | 10 |
| Balance at December 31, 2009 | \$ | 173 | \$ | 10 |
| Total Gains or Losses (Realized/Unrealized): | | | | |
| Included in Other Noninterest Expense | | (35) | | - |
| Included in Other Comprehensive Loss | | 20 | | - |
| Purchases | | - | | - |
| Sales | | - | | - |
| Issuances | | - | | 3 |
| Settlements | | (28) | | (3) |
| Balance at September 30, 2010 | \$ | 130 | \$ | 10 |

Estimated Fair Value of Financial Instruments

The following table presents the estimated fair values of financial instruments that are recorded in the consolidated balance sheets at cost, as well as certain off-balance sheet financial instruments, as of September 30, 2011 and December 31, 2010.

| Estimated Fair Value of Financial Instruments | | | | |
|--|----------------------------|---------------------------------|----------------------------|---------------------------------|
| | September 30, 2011 | | December 31, 2010 | |
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| (\$ in Millions) | | | | |
| Financial Assets: | | | | |
| Net Loans | \$ 44,637 | \$ 46,441 | \$ 49,592 | \$ 50,613 |
| Financial Liabilities: | | | | |
| Bonds and Notes | \$ 55,295 | \$ 56,780 | \$ 59,324 | \$ 60,094 |
| Subordinated Debt | 1,000 | 930 | 1,000 | 953 |
| Off-Balance Sheet Financial Instruments: | | | | |
| Commitments to Extend Credit | \$ - | \$ (94) | \$ - | \$ (80) |

Net Loans

Our loan portfolio includes fixed- and floating-rate loans. Since no active trading market exists for most of our loans, fair value is estimated by discounting the expected future cash flows using current interest rates at which similar loans would be made to borrowers with similar credit risk.

Bonds and Notes

Bonds and notes are not all regularly traded in the secondary market and those that are traded may not have readily available quoted market prices. To the extent that quoted market prices are not readily available, the fair value of these instruments is estimated by discounting expected future cash flows based on the quoted market price of similar maturity U.S. Treasury notes, assuming a constant estimated yield spread relationship between Systemwide bonds and notes and comparable U.S. Treasury notes.

Subordinated Debt

The fair value of subordinated debt is estimated based upon quotes obtained from a broker/dealer.

Commitments to Extend Credit

The fair value of commitments to extend credit is estimated by applying a risk-adjusted spread percentage to these obligations.

Note 6 – Employee Benefit Plans

We have employer-funded, qualified defined benefit pension plans, which are noncontributory and cover employees hired prior to January 1, 2007. We also have a noncontributory, unfunded nonqualified supplemental executive retirement plan (SERP) covering senior officers and specified other senior managers, as well as a noncontributory, unfunded nonqualified executive retirement plan (ERP) designed to provide enhanced retirement benefits to two senior officers employed pursuant to employment agreements. We have a 401(k) retirement savings plan pursuant to which we match a certain percentage of employees' elective contributions. In addition, under this plan, employees hired on or after January 1, 2007 receive additional employer defined contributions. For eligible senior managers, including our senior officers, we also have a nonqualified deferred compensation plan, which includes benefits not provided under the employee savings plan due to certain Internal Revenue Code limitations.

All retirement-eligible employees are also currently eligible for other postretirement benefits, which primarily include access to healthcare benefits. Substantially all participants pay the full premiums associated with these other postretirement healthcare benefits. Participant contributions are adjusted annually.

We contributed \$2.4 million to our funded qualified defined benefit pension plans during the nine months ended September 30, 2011, and anticipate that we will contribute approximately \$1.1 million more to such plans during the remainder of 2011. We expect to contribute a total of \$0.1 million, net of collected retiree premiums, to our other postretirement benefit plans in 2011. We contributed \$1.0 million to our trust funds related to our SERP and ERP during the nine months ended September 30, 2011, and anticipate that we will contribute approximately \$0.6 million more to such plans during the remainder of 2011. Our actual contributions could differ from the estimates noted above.

Note 7 – Commitments and Contingent Liabilities

At September 30, 2011, various lawsuits were pending or threatened against the Bank, in which claims for monetary damages have been or may be asserted. In the opinion of management, based on information currently available and taking into account the advice of legal counsel, the ultimate liability, if any, of pending or threatened legal actions will not have a material adverse impact on our consolidated results of operations or financial position.

Under the Farm Credit Act of 1971, as amended, CoBank is primarily liable for its portion of Systemwide debt securities. Additionally, we are contingently liable for the Systemwide debt securities of the other System banks. Total Systemwide debt securities of the System were \$183.4 billion at September 30, 2011.

There are several mechanisms in place affecting exposure to statutory joint and several liabilities. These mechanisms include:

- The statutory requirement for System banks to maintain eligible assets at a level at least equal in value to the total amount of debt for which such System bank is primarily liable;
- The Farm Credit Insurance Fund (Insurance Fund), a statutorily created insurance fund to assist in the timely payment of principal and interest on Systemwide debt securities in the event of a default by a System bank to the extent that net assets are available in the Insurance Fund. At September 30, 2011, the assets of the Insurance Fund aggregated \$3.4 billion; and
- Maintenance of certain financial criteria by agreements which, if not met, could limit or ultimately deny a troubled System bank's access to and participation in System debt issuances.

Note 8 – Segment Financial Information

We conduct our lending operations through three operating segments: Agribusiness, Strategic Relationships and Rural Infrastructure.

The accompanying tables present condensed disaggregated information for the segments. Allocations of resources and corporate items, as well as measurement of financial performance, are made at these operating segment levels. We also allocate to our segments net interest income on investment securities. Information to reconcile the total reportable segments to the total CoBank financial statements is shown as "other." Inter-segment transactions are insignificant.

We do not hold significant assets in any foreign country. Substantially all of our agricultural export finance loans are U.S. dollar-denominated and the majority of these loans are guaranteed by a U.S. government-sponsored loan guarantee program.

For the nine-month period ended September 30, 2011, no customer made up 10 percent or more of our gross or net interest income. For the nine-month period ended September 30, 2010, interest earned from an affiliated Association, Northwest, represented 10 percent of our gross interest income and less than 10 percent of our net interest income. No other customer made up 10 percent or more of our gross or net interest income for the nine-month period ended September 30, 2010.

Segment Financial Information

For the Three Months Ended September 30, 2011

| | Agribusiness | Strategic Relationships | Rural Infrastructure | Subtotal | Other | Total CoBank |
|---|-------------------|-------------------------|----------------------|-------------------|-------------------|-------------------|
| Results of Operations (\$ in Thousands): | | | | | | |
| Net Interest Income | \$ 155,369 | \$ 21,676 | \$ 76,644 | \$ 253,689 | \$ (1,694) | \$ 251,995 |
| Provision for Loan Losses | 10,500 | - | 2,000 | 12,500 | - | 12,500 |
| Noninterest Income | 21,311 | 204 | 7,419 | 28,934 | (672) | 28,262 |
| Operating Expenses | 35,761 | 3,885 | 16,558 | 56,204 | (70) | 56,134 |
| Provision for Income Taxes | 27,023 | - | 15,235 | 42,258 | (552) | 41,706 |
| Net Income | \$ 103,396 | \$ 17,995 | \$ 50,270 | \$ 171,661 | \$ (1,744) | \$ 169,917 |

For the Three Months Ended September 30, 2010

| | | | | | | |
|---|------------------|------------------|------------------|-------------------|-------------------|-------------------|
| Results of Operations (\$ in Thousands): | | | | | | |
| Net Interest Income | \$ 129,122 | \$ 18,685 | \$ 79,733 | \$ 227,540 | \$ (1,264) | \$ 226,276 |
| Provision (Reversal) for Loan Losses | (1,500) | - | 22,500 | 21,000 | - | 21,000 |
| Noninterest Income | 1,603 | 258 | 1,784 | 3,645 | (337) | 3,308 |
| Operating Expenses | 27,332 | 3,368 | 11,949 | 42,649 | 638 | 43,287 |
| Provision for Income Taxes | 25,808 | - | 7,982 | 33,790 | (451) | 33,339 |
| Net Income | \$ 79,085 | \$ 15,575 | \$ 39,086 | \$ 133,746 | \$ (1,788) | \$ 131,958 |

Segment Financial Information

For the Nine Months Ended September 30, 2011

| | Agribusiness | Strategic Relationships | Rural Infrastructure | Subtotal | Other | Total CoBank |
|---|-------------------|-------------------------|----------------------|-------------------|-------------------|-------------------|
| Results of Operations (\$ in Thousands): | | | | | | |
| Net Interest Income | \$ 537,325 | \$ 74,366 | \$ 222,779 | \$ 834,470 | \$ (4,734) | \$ 829,736 |
| Provision for Loan Losses | 39,500 | - | 10,500 | 50,000 | - | 50,000 |
| Noninterest Income | 62,738 | 565 | 30,801 | 94,104 | (1,654) | 92,450 |
| Operating Expenses | 106,161 | 11,520 | 47,973 | 165,654 | (119) | 165,535 |
| Provision for Income Taxes | 100,607 | - | 44,908 | 145,515 | (1,570) | 143,945 |
| Net Income | \$ 353,795 | \$ 63,411 | \$ 150,199 | \$ 567,405 | \$ (4,699) | \$ 562,706 |

Selected Financial Information at September 30, 2011 (\$ in Millions):

| | | | | | | |
|---------------------------------|------------------|------------------|------------------|------------------|--------------------|------------------|
| Loans | \$ 17,876 | \$ 15,193 | \$ 11,959 | \$ 45,028 | \$ - | \$ 45,028 |
| Less: Allowance for Loan Losses | (281) | - | (110) | (391) | - | (391) |
| Net Loans | \$ 17,595 | \$ 15,193 | \$ 11,849 | \$ 44,637 | \$ - | \$ 44,637 |
| Total Assets | \$ 17,707 | \$ 15,239 | \$ 11,909 | \$ 44,855 | \$ 17,481 * | \$ 62,336 |

*Other assets are comprised of:

| | | | | | | |
|-----------------------|--|--|--|--|----|--------|
| Investment Securities | | | | | \$ | 13,237 |
| Other Assets | | | | | | 4,244 |

For the Nine Months Ended September 30, 2010

Results of Operations (\$ in Thousands):

| | | | | | | |
|--------------------------------------|-------------------|------------------|-------------------|-------------------|-------------------|-------------------|
| Net Interest Income | \$ 373,583 | \$ 69,888 | \$ 234,882 | \$ 678,353 | \$ (3,454) | \$ 674,899 |
| Provision (Reversal) for Loan Losses | (7,000) | - | 44,500 | 37,500 | - | 37,500 |
| Noninterest Income | 48,012 | 624 | 30,295 | 78,931 | (505) | 78,426 |
| Operating Expenses | 78,681 | 10,008 | 61,087 | 149,776 | 3,335 | 153,111 |
| Provision for Income Taxes | 80,906 | - | 32,267 | 113,173 | (1,448) | 111,725 |
| Net Income | \$ 269,008 | \$ 60,504 | \$ 127,323 | \$ 456,835 | \$ (5,846) | \$ 450,989 |

Selected Financial Information at September 30, 2010 (\$ in Millions):

| | | | | | | |
|---------------------------------|------------------|------------------|------------------|------------------|--------------------|------------------|
| Loans | \$ 19,440 | \$ 15,290 | \$ 11,737 | \$ 46,467 | \$ - | \$ 46,467 |
| Less: Allowance for Loan Losses | (237) | - | (129) | (366) | - | (366) |
| Net Loans | \$ 19,203 | \$ 15,290 | \$ 11,608 | \$ 46,101 | \$ - | \$ 46,101 |
| Total Assets | \$ 19,329 | \$ 15,339 | \$ 11,672 | \$ 46,340 | \$ 13,955 * | \$ 60,295 |

*Other assets are comprised of:

| | | | | | | |
|-----------------------|--|--|--|--|----|--------|
| Investment Securities | | | | | \$ | 11,090 |
| Other Assets | | | | | | 2,865 |

Supplemental District Financial Information

CoBank, ACB and Affiliated Associations

Our affiliated Associations operate independently and maintain an arms-length relationship with us, except to the limited extent that the Farm Credit Act requires us, as the funding bank, to monitor and approve certain activities of affiliated Associations. Accordingly, the financial information of affiliated Associations is not included in our consolidated financial statements. However, because of the interdependent manner in which CoBank and its affiliated Associations operate, we believe that presenting combined Bank and Association financial information is meaningful for purposes of additional analysis.

The Combining Balance Sheets and Income Statements, ratios and other financial information on pages 40 and 41 present condensed combined financial information of CoBank and its affiliated Associations, which are collectively referred to as the District. As part of the combining process, all significant transactions between CoBank and its affiliated Associations, including loans made by the Bank to the affiliated Associations and the interest income/interest expense related thereto, and investments of the affiliated Associations in the Bank and the earnings related thereto, have been eliminated.

District Results of Operations and Financial Condition

District net income increased to \$728 million for the nine months ended September 30, 2011 compared to \$612 million during the same period in 2010. The combined net income of the Associations increased to \$213 million for the nine months ended September 30, 2011 compared to \$204 million during the same period of 2010. The increase in combined Association net income was primarily the result of improved net interest income and a decrease in the provision for loan losses, offset in part by lower noninterest income. Association net interest income increased by \$20 million due to increased lending spreads, primarily due to lower funding costs, and, to a lesser extent, an increase in average loan volume. The combined Associations' provision for loan losses decreased to \$49 million in the first nine months of 2011 compared to \$59 million in the 2010 period. Notwithstanding the lower provision for loan losses in 2011, credit challenges in the dairy, timber and nursery industries could lead to a decline in the credit quality of the Associations' retail loan portfolio and an increase in their provisions for loan losses. Association noninterest income decreased by \$13 million largely due to refunds of Farm Credit insurance fund premiums received in the 2010 period.

As of September 30, 2011, the combined Associations' shareholders' equity was \$2.4 billion and capital levels at all individual Associations were well in excess of minimum regulatory capital requirements.

Supplemental District Financial Information

CoBank, ACB and Affiliated Associations

Combining Balance Sheets (Condensed)

(\$ in Millions) (Unaudited)

| As of September 30, 2011 | CoBank | Combined Affiliated Associations | Eliminations | Combined District |
|---|------------------|--|--------------------|----------------------|
| Investments | \$ 13,237 | \$ - | \$ - | 13,237 |
| Loans | 45,028 | 13,215 | (11,164) | 47,079 |
| Less: Allowance for Loan Losses | (391) | (195) | - | (586) |
| Net Loans | 44,637 | 13,020 | (11,164) | 46,493 |
| Other Assets | 4,462 | 791 | (567) | 4,686 |
| Total Assets | \$ 62,336 | \$ 13,811 | \$ (11,731) | \$ 64,416 |
| Bonds and Notes | \$ 56,295 | \$ 11,304 | \$ (11,199) | \$ 56,400 |
| Reserve for Unfunded Commitments | 143 | 13 | - | 156 |
| Other Liabilities | 1,043 | 131 | (54) | 1,120 |
| Total Liabilities | 57,481 | 11,448 | (11,253) | 57,676 |
| Total Shareholders' Equity | 4,855 | 2,363 | (478) | 6,740 |
| Total Liabilities and Shareholders' Equity | \$ 62,336 | \$ 13,811 | \$ (11,731) | \$ 64,416 |
| As of December 31, 2010 | | | | |
| Investments | \$ 12,617 | \$ - | \$ - | 12,617 |
| Loans | 49,992 | 13,149 | (11,327) | 51,814 |
| Less: Allowance for Loan Losses | (400) | (176) | - | (576) |
| Net Loans | 49,592 | 12,973 | (11,327) | 51,238 |
| Other Assets | 3,617 | 810 | (582) | 3,845 |
| Total Assets | \$ 65,826 | \$ 13,783 | \$ (11,909) | \$ 67,700 |
| Bonds and Notes | \$ 60,324 | \$ 11,403 | \$ (11,364) | \$ 60,363 |
| Reserve for Unfunded Commitments | 100 | 7 | - | 107 |
| Other Liabilities | 996 | 148 | (68) | 1,076 |
| Total Liabilities | 61,420 | 11,558 | (11,432) | 61,546 |
| Total Shareholders' Equity | 4,406 | 2,225 | (477) | 6,154 |
| Total Liabilities and Shareholders' Equity | \$ 65,826 | \$ 13,783 | \$ (11,909) | \$ 67,700 |

Supplemental District Financial Information

CoBank, ACB and Affiliated Associations

Combining Statements of Income (Condensed)

(\$ in Millions) (Unaudited)

| For the Nine Months Ended September 30, | CoBank | Combined Affiliated Associations | Eliminations | Combined District |
|---|---------------|--|----------------|----------------------|
| 2011 | | | | |
| Net Interest Income | \$ 830 | \$ 318 | \$ - | \$ 1,148 |
| Provision for Loan Losses | 50 | 49 | - | 99 |
| Noninterest Income | 92 | 81 | (48) | 125 |
| Operating Expenses | 165 | 131 | - | 296 |
| Provision for Income Taxes | 144 | 6 | - | 150 |
| Net Income | \$ 563 | \$ 213 | \$ (48) | \$ 728 |
| 2010 | | | | |
| Net Interest Income | \$ 675 | \$ 298 | \$ - | \$ 973 |
| Provision for Loan Losses | 38 | 59 | - | 97 |
| Noninterest Income | 78 | 94 | (43) | 129 |
| Operating Expenses | 153 | 125 | - | 278 |
| Provision for Income Taxes | 111 | 4 | - | 115 |
| Net Income | \$ 451 | \$ 204 | \$ (43) | \$ 612 |

Key Financial Ratios – Combined CoBank District

(Unaudited)

| For the Nine Months Ended September 30, | 2011 | 2010 |
|---|---------------------------|--------------------------|
| Return on Average Assets | 1.38 % | 1.36 % |
| Return on Average Capital | 13.97 | 13.83 |
| Net Interest Margin | 2.30 | 2.25 |
| Operating Expenses as a Percent of Net Interest Income and Noninterest Income | 23.17 | 25.28 |
| Net Charge-offs as a Percent of Average Loans | 0.10 | 0.24 |
| | September 30, 2011 | December 31, 2010 |
| Reserve for Credit Exposure as a Percent of Loans | 1.57 % | 1.32 % |
| Capital as a Percent of Total Assets | 10.46 | 9.09 |
| Risk Funds as a Percent of Loans | 15.89 | 13.19 |
| Debt to Capital (:1) | 8.56 | 10.00 |

Loan Quality Ratios – Combined CoBank District

(Unaudited)

| | September 30, 2011 | December 31, 2010 |
|-----------------|--------------------|-------------------|
| Acceptable | 91.31 % | 91.48 % |
| Special Mention | 5.48 | 5.13 |
| Substandard | 3.06 | 3.24 |
| Doubtful | 0.15 | 0.15 |
| Loss | - | - |
| Total | 100.00 % | 100.00 % |

Controls and Procedures

CoBank, ACB

We maintain a system of disclosure controls and procedures. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information disclosed by us in our quarterly and annual reports is accumulated and communicated to our management, including our principal executive officer and our principal financial officer, as appropriate, to allow timely decisions to be made regarding disclosure. The president and chief executive officer, and the chief financial officer have evaluated our disclosure controls and procedures as of the end of the period covered by this quarterly report and have concluded that our disclosure controls and procedures are effective as of that date.

We also maintain a system of internal controls. The term “internal controls,” as defined by the American Institute of Certified Public Accountants’ Codification of Statement on Auditing Standards, AU Section 319, means a process - effected by the board of directors, management and other personnel - designed to provide reasonable assurance regarding the achievement of objectives in reliability of financial reporting, the effectiveness and efficiency of operations and compliance with applicable laws and regulations. We continually assess the adequacy of our internal control over financial reporting and enhance our controls in response to internal control assessments and internal and external audit and regulatory recommendations. There have been no significant changes in our internal controls or in other factors that could significantly affect such controls subsequent to the date we carried out our evaluations. In accordance with our internal control procedures, these financial statements were prepared under the oversight of the Audit Committee of our Board of Directors.

Certification Required by Farm Credit Administration Regulations

The undersigned have reviewed this quarterly report which has been prepared in accordance with all applicable statutory or regulatory requirements and certify that the information contained herein is true, accurate, and complete to the best of our knowledge and belief.

Signed this 9th day of November, 2011.

/s/ EVERETT DOBRINSKI

Everett Dobrinski
Chairman of the Board

/s/ ROBERT B. ENGEL

Robert B. Engel
President and Chief Executive Officer

/s/ DAVID P. BURLAGE

David P. Burlage
Chief Financial Officer

CERTIFICATION

I, Robert B. Engel, President and Chief Executive Officer of CoBank, ACB (CoBank or the Bank), a federally chartered instrumentality under the Farm Credit Act of 1971, as amended, certify that:

- (1) I have reviewed this quarterly report of CoBank;
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of CoBank as of, and for, the periods presented in this report;
- (4) CoBank's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for CoBank and have:
 - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Bank, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. evaluated the effectiveness of the Bank's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. disclosed in this report any change in the Bank's internal control over financial reporting that occurred during the Bank's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting; and
- (5) CoBank's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Bank's auditors and the audit committee of the Bank's board of directors (or persons performing the equivalent functions):
 - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize, and report financial information; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the Bank's internal control over financial reporting.

/s/ ROBERT B. ENGEL

Robert B. Engel
President and Chief Executive Officer

Dated: November 9, 2011

CERTIFICATION

I, David P. Burlage, Chief Financial Officer of CoBank, ACB (CoBank or the Bank), a federally chartered instrumentality under the Farm Credit Act of 1971, as amended, certify that:

- (1) I have reviewed this quarterly report of CoBank;
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of CoBank as of, and for, the periods presented in this report;
- (4) CoBank's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for CoBank and have:
 - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Bank, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. evaluated the effectiveness of the Bank's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. disclosed in this report any change in the Bank's internal control over financial reporting that occurred during the Bank's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting; and
- (5) CoBank's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Bank's auditors and the audit committee of the Bank's board of directors (or persons performing the equivalent functions):
 - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize, and report financial information; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the Bank's internal control over financial reporting.

/s/ DAVID P. BURLAGE

David P. Burlage
Chief Financial Officer

Dated: November 9, 2011

Leadership

CoBank, ACB

Robert B. Engel, President and Chief Executive Officer

Mary E. McBride, Chief Banking Officer

Agribusiness

Amy H. Gales, Regional Agribusiness Banking Group*

Robert E. Egerton, Agribusiness Division – East

Michael W. Hechtner, Agribusiness Division – Central

Mark C. Nonnenmacher, Agribusiness Division – West

Lynn M. Scherler, Agribusiness Division – South

Jonathan B. Logan, Corporate Agribusiness Banking Group

Leili Ghazi, Agricultural Export Finance

Rural Infrastructure

Paul A. Narduzzo, Rural Infrastructure Banking Group

Brett A. Challenger, Energy and Water Services Banking Division

Candace A. Roper, Electric Distribution Banking Division

Todd E. Telesz, Power Supply Banking Division

Robert F. West, Communications Banking Division

Banking Services

Antony M. Bahr, Banking Services Group

Brian J. Klatt, Capital Markets Division

Russell D. Nelson, Farm Credit Leasing Services Corporation**

Leonard G. Sahling, Knowledge Exchange Division

Richard A. Scholz, Non-Credit Services Division

Ann E. Trakimas, Chief Operating Officer

Finance

David P. Burlage, Chief Financial Officer

Timothy D. Steidle, Treasury Division

Michael R. Vestal, Controller Division

Business Support Services

John Svisco, Chief Administrative Officer

James R. Bernsten, Chief Information Officer

Arthur C. Hodges, Jr., Corporate Communications Division

Robert L. O'Toole, Human Resources Division

Todd E. Wilson, Operations Division

Regulatory, Legislative and Compliance

Andrew D. Jacob, Regulatory, Legislative and Compliance

L. Todd VanHoose, Government Affairs

Legal

Gregory J. Buehne, General Counsel

Andrew J. Romanow, Deputy General Counsel

Douglas E. Wilhelm, Chief Risk Officer

Rodney A. Brown, Asset Review Division

Gary M. Fitzgerald, Internal Audit Division

Lori L. O'Flaherty, Chief Credit Officer

Daniel L. Key, Credit Approval Division

Ronald P. Seigley, Special Assets Division

* The Strategic Relationships operating segment is included within the Regional Agribusiness Banking Group.

** Farm Credit Leasing Services Corporation is included in our Agribusiness operating segment.

Office Locations

CoBank, ACB

CoBank National Office and Denver Banking Center

5500 S. Quebec Street
Greenwood Village, CO 80111
P. O. Box 5110
Denver, CO 80217
(303) 740-4000
(800) 542-8072

Farm Credit Leasing Services Corporation

600 Highway 169 South, Suite 300
Minneapolis, MN 55426
(952) 417-7800
(800) 444-2929

Washington, DC Office

50 F Street, N.W., Suite 900
Washington, DC 20001
(202) 650-5860

U.S. Regional Offices

Ames Banking Center

2515 University Boulevard, Suite 104
Ames, IA 50010
(515) 292-8828

*Atlanta Banking Center ***

900 Circle 75 Parkway, Suite 1400
Atlanta, GA 30339-5946
(770) 618-3200
(800) 255-7429
FCL: (770) 618-3226

Austin Banking Center

4801 Plaza on the Lake Drive
Austin, TX 78746
(512) 483-9273

*California Farm Credit Leasing Office **

2345 East Earhart Avenue
Stockton, CA 95206
P.O. Box 31990
Stockton, CA 95213
(209) 944-7478

*Enfield Banking Center ***

240B South Road
Enfield, CT 06082-4451
(860) 814-4043
(800) 876-3227
FCL: (860) 814-4049

Fargo Banking Center

Goldmark Office Park
1711 Gold Drive South, Suite 230
Fargo, ND 58103
(701) 277-5007
(866) 280-2892

*Louisville Banking Center ***

1601 UPS Drive, Suite 102
Louisville, KY 40223
(502) 423-5650
(800) 262-6599
FCL: (800) 942-3309

*Lubbock Banking Center ***

5715 West 50th
Lubbock, TX 79414
P.O. Box 6770
Lubbock, TX 79493
(806) 788-3700
(877) 610-6987
FCL: (806) 788-3705

*Minneapolis Banking Center ***

600 Highway 169 South, Suite 300
Minneapolis, MN 55426
(952) 417-7900
(800) 282-4150
FCL: (800) 444-2929

*North Carolina Farm Credit Leasing Office**

146 Victory Lane
Statesville, NC 28625
(443) 452-8666

*Omaha Banking Center ***

11422 Miracle Hills Drive, Suite 300
Omaha, NE 68154-4404
(402) 492-2000
(800) 346-5717

*Sacramento Banking Center ***

1478 Stone Point Drive, Suite 450
Roseville, CA 95661
(916) 380-3524
(800) 457-0942
FCL: (800) 289-7080

Spokane Banking Center

1700 South Assembly Street,
Suite 103
Spokane, WA 99224-2121
P.O. Box 2720
Spokane, WA 99220-2720
(509) 363-8700
(800) 378-5577

Sterling Banking Center

229 South 3rd Street
Sterling, CO 80751
(970) 521-2774

*St. Louis Banking Center ***

1650 Des Peres Road, Suite 120
St. Louis, MO 63131
(314) 835-4200
(800) 806-4144
FCL: (800) 853-5480

*Wichita Banking Center ***

245 North Waco, Suite 230
Wichita, KS 67202
P.O. Box 2940
Wichita, KS 67201-2940
(316) 290-2000
(800) 322-3654
FCL: (800) 322-6558

International

Singapore Representative Office

10 Hoe Chiang Road
#05-01 Keppel Towers
Singapore 089315
(65) 6534-5261

* *Farm Credit Leasing office only*

** *Farm Credit Leasing office within this CoBank location*

CoBank's 2011 Quarterly and Annual Reports to Shareholders are available free of charge on request by calling or visiting one of our banking center locations and through our website at www.cobank.com on approximately May 9, 2011, August 9, 2011, November 9, 2011, and March 1, 2012 (Annual Report).



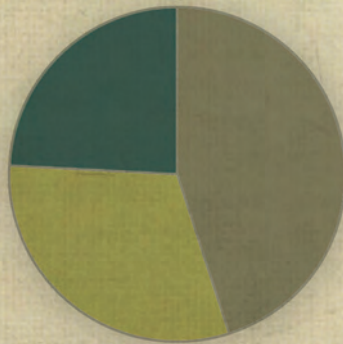
FULFILLING OUR MISSION

2010
Annual
Report

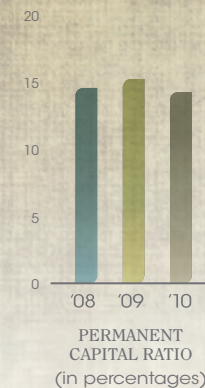
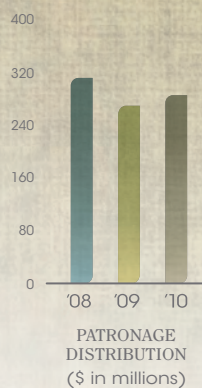
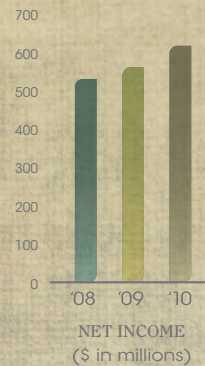
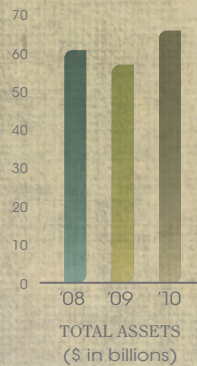


2010 FINANCIAL HIGHLIGHTS

LOAN PORTFOLIO



| | |
|---------------------------|-----|
| ■ Agribusiness | 45% |
| ■ Strategic Relationships | 31% |
| ■ Rural Infrastructure | 24% |



| For the Year (\$ in millions) | 2010 | 2009 | 2008 |
|-------------------------------|--------|--------|--------|
| Net Interest Income | \$ 951 | \$ 946 | \$ 863 |
| Provision for Loan Losses | 60 | 80 | 55 |
| Net Income | 614 | 565 | 533 |
| Patronage Distribution | 285 | 269 | 314 |

| At Year End (\$ in millions) | 2010 | 2009 | 2008 |
|------------------------------|-----------|-----------|-----------|
| Agribusiness | \$ 22,676 | \$ 17,469 | \$ 18,498 |
| Strategic Relationships | 15,392 | 15,271 | 15,026 |
| Rural Infrastructure | 11,924 | 11,434 | 11,026 |
| Total Loans | 49,992 | 44,174 | 44,550 |
| Reserve for Credit Exposure | 501 | 498 | 483 |
| Total Assets | 65,826 | 58,161 | 61,162 |
| Total Shareholders' Equity | 4,406 | 4,058 | 3,595 |

| Financial Ratios for the Year | 2010 | 2009 | 2008 |
|------------------------------------|--------|--------|--------|
| Return on Average Common Equity | 15.31% | 15.96% | 17.32% |
| Return on Average Assets | 1.03 | 0.93 | 0.91 |
| Return on Active Patron Investment | 19.77 | 19.68 | 25.10 |
| Net Interest Margin | 1.66 | 1.66 | 1.51 |
| Permanent Capital Ratio | 14.30 | 15.29 | 14.75 |

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12..... Strategic Relationships
14..... Electric Distribution Banking Division
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**CoBANK'S MISSION,
AS AN INTEGRAL MEMBER OF
THE FARM CREDIT SYSTEM,
IS TO SERVE AS A
DEPENDABLE PROVIDER
OF CREDIT AND OTHER
FINANCIAL SERVICES TO
VITAL INDUSTRIES ACROSS
RURAL AMERICA.**

Proud Member of the Farm Credit System





EVERETT DOBRINSKI
Chairman

ROBERT B. ENGEL
President and CEO

To Our Shareholders

.....

Officially, the year 2010 was one of recovery for American households and the broader U.S. economy. The nation's gross domestic product grew throughout the year, and more than 1 million jobs were created in the public and private sectors combined. Inflation remained well under control, and home prices began to stabilize in many regions of the country. The banking industry, a vital source of capital for businesses and consumers alike, saw a rebound in overall profitability. Equity markets produced a notable rally.

Despite those trends, however, most observers remain rightly cautious about the strength and sustainability of the recovery and the U.S. economy's health. GDP and job growth rates, while positive, have been anemic by the standard of past

recoveries. Extraordinary fiscal and monetary measures taken by the federal government to boost economic activity in the short run have exacerbated public indebtedness and threaten to create other long-term problems. The confidence of the American consumer — in the recovery and in the ability of our country's leaders to steer the right course — remains shaken.

We're pleased to report that, against that difficult backdrop, CoBank enjoyed another year of extraordinary success. The bank recorded its 11th consecutive year of net income growth, enabling it to further build its capital base and return strong levels of patronage to its customer-owners throughout the country. More importantly, the bank continued to provide its customers with dependable credit and other financial services they rely on to operate, grow and compete in today's increasingly volatile and complex economic environment.

"FULFILLING OUR MISSION"

The theme of our annual report this year is "Fulfilling Our Mission." Like all institutions in the Farm Credit System, CoBank has a higher purpose beyond generating profits and a return on investment for shareholders. We are proud of our strong financial performance. But we care foremost about fulfilling our government-chartered mission to serve agribusinesses, rural infrastructure providers and Farm Credit associations around the country that count on CoBank to stand by them in both good times and bad.

The pages that follow contain numerous examples of our value proposition in action. During the year, CoBank employees worked with customers to close a wide variety of noteworthy business transactions, many focused on expansion and future growth. Examples include a new, 250-mile power transmission line in the Upper Midwest; the construction of a 1-million-bushel grain bin at an Illinois farm co-op; the development of a water treatment system serving rural communities in northwestern Iowa; and a cutting-edge communications network in a small Kansas town.

CoBank also worked with customers who experienced challenge and distress. Consider Leaf River Ag Services, a full-service grain and farm supply cooperative in rural Minnesota. When its facilities were badly damaged by a tornado in June of last year, our people worked quickly to provide the co-op with emergency support — and also pitched in to help with the clean-up effort.

These stories showcase the strength and diversity of the CoBank customer base and the spirit of optimism at the heart of America's rural economy. Taken together, they also clearly illustrate the CoBank brand promise and the difference a mission-based lender can make in the lives of its customers.

EXCEPTIONAL FINANCIAL PERFORMANCE

By virtually any measure, CoBank's financial performance in 2010 was exceptional. Net income grew 9 percent to \$614 million, an all-time high. Despite an economy in which overall demand for debt capital remained weak, average loan volumes increased at CoBank by more than 2 percent. Key drivers behind the rise in volume included higher commodity prices, which increased seasonal borrowing

**CoBank HAS A HIGHER
PURPOSE BEYOND
GENERATING PROFITS AND
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FOR SHAREHOLDERS.**

**BY VIRTUALLY ANY MEASURE,
CoBANK'S FINANCIAL
PERFORMANCE IN 2010
WAS EXCEPTIONAL.**

by our agribusiness customers, as well as increased lending to rural electric cooperatives around the country. Wholesale lending to partner associations across the Farm Credit System was essentially flat. We saw lower volumes in some other sectors, including export financing and rural communications.

Credit quality across the bank's \$50 billion loan portfolio continues to improve. The so-called Great Recession of 2008 and 2009 stressed customers in a number of the industries we serve, including livestock, dairy, communications and others. In 2010, we saw improvement across a number of loan quality indicators. Although we recorded a provision for credit losses of \$60 million during the year, that number was down from 2009 — a hopeful sign that the worst impacts of the recession on our overall credit quality are behind us. It's important to note that, throughout the recession, credit quality at CoBank remained well within the risk-bearing capacity of the enterprise. We have also prudently built a reserve for credit exposure totaling over \$500 million that will continue to protect the bank and its customer-owners in the face of persistently challenging economic conditions.

Strong earnings will once again enable CoBank to fully fund its patronage program, a key component of our value proposition. In March, the bank will distribute a total of \$285 million in cash and equity patronage, which for most cooperative and corporate borrowers will amount to 100 basis points of their average daily loan balance for the prior year. Patronage effectively lowers the net cost of borrowing for our customers and is a significant benefit they derive from choosing CoBank as their financial partner.

As we have emphasized before, our net income also enables CoBank to build its capital position through the portion of our earnings that we retain. Our capital foundation serves

as an important line of defense for the bank against loan losses that inevitably occur during periods of economic distress. It also provides us with the capacity we need to fulfill our mission and meet the increasing borrowing requirements of our agribusiness, rural infrastructure and Farm Credit association customers.

The detailed financial information contained in this annual report provides a wealth of data about all aspects of the bank's financial condition and results of operations, including credit quality, capital levels, liquidity and the operating performance of individual business segments. We urge all of our shareholders to review that information in detail, as we are committed to maintaining transparency in our financial reporting. We believe that doing so is one of the best ways to ensure the trust and confidence of our customer-owners, Farm Credit partners and other key stakeholders.

THE STRENGTH OF FARM CREDIT

Like CoBank, the broader Farm Credit System also recorded strong financial results in 2010. Combined, the System's 90 banks and associations recorded net income of \$3.5 billion, up 23 percent from 2009. Today, the System's total assets are approximately \$230 billion, making it the leading provider of credit to American farmers, ranchers, cooperatives and other rural borrowers.

Membership in the Farm Credit System is at the heart of the CoBank value proposition. It gives us

the ability to deliver dependable, competitively priced credit to our customer-owners in all kinds of market conditions. And our partnerships with other Farm Credit entities substantially enhance our overall lending capacity and our collective ability to provide financial products and services to customers across rural America.

The rural economy has changed a great deal since the Farm Credit System was founded almost 100 years ago. But given the tremendous volatility Farm Credit's customers have managed through over the past couple of years, we believe the mission of the System has never been more important than it is today.

PROPOSED MERGER WITH U.S. AGBANK

In December 2010, the CoBank board of directors unanimously approved a letter of intent to merge with U.S. AgBank, one of the four other funding banks in the Farm Credit System. Based in Wichita, Kansas, U.S. AgBank, whose board also unanimously approved the letter of intent, has approximately \$25 billion in assets and functions as a wholesale provider of financing to 26 Farm Credit associations serving rural borrowers in 11 states.

The merged bank would continue to do business under the CoBank name and remain headquartered outside Denver, Colorado, with Bob Engel continuing as president and chief executive officer. With approximately \$90 billion in assets, the combined

organization would be an even stronger, more diversified financial services institution, with enhanced capacity to fulfill our mission serving rural America and to weather periods of economic turmoil and volatility.

A key benefit of the proposed transaction is an increase in the geographic and industry diversification of the bank's loan portfolio, which will enhance its risk-bearing capacity. CoBank's current portfolio covers all 50 states, but it has higher concentrations in the Midwest region of the country and in the grain, farm supply and rural energy sectors. The U.S. AgBank portfolio, meanwhile, is more heavily concentrated in the Plains states, the Southwest and California. From an industry standpoint, U.S. AgBank's highest concentrations are in fruits, nuts and vegetables, dairy and livestock. At the combined bank, concentration risk will be spread more broadly across industries and a much broader wholesale lending territory.

Our revenue sources will also remain well-balanced. The combined bank will generate earnings from three principal operating segments — agribusiness, rural infrastructure, and wholesale lending to Farm Credit associations — as well as earnings from treasury-related activities. Post-merger, no single segment is expected to account for more than 40 percent of total revenue, further protecting the bank against risks or disruptions that may impact any one part of the business.

The merged bank would continue to be organized and operate as a cooperative, with eligible borrowers earning cash and equity patronage based on the amount of business they do with the organization. On the effective date of the merger, the CoBank and U.S. AgBank boards would be temporarily combined. Following a transition period, the merged bank's board would have directors elected from six regions across the country under both a one-member-one-vote and modified-equity basis — an arrangement that has been successfully used at CoBank for over 20 years. The board would also have a number of outside and appointed directors.

Complete details on the combined bank's governance structure will be provided to stockholders in mid-2011, once merger disclosure materials are finalized. Good governance is at the heart of the cooperative model. We are committed to maintaining a strong governance structure that gives all our customers a fair and equitable voice in the future direction of the business and that will serve our owners and the bank effectively for the long term.

Our merger is subject to a number of conditions, including the approval of CoBank and U.S. AgBank shareholders as well as our regulator, the Farm Credit Administration. We anticipate asking our stockholders to approve the merger this summer. The earliest we expect the merger to close is October 1, 2011. We're committed to open and transparent communication at CoBank, and we will be in regular contact with our customers and other stakeholders throughout the year in

order to ensure they have all the information they need to understand and evaluate the transaction.

We strongly believe the merger will benefit all of our customers and position the bank as a safe, sound, dependable provider of credit to rural America for future generations.

CORPORATE CITIZENSHIP

Along with dependably serving the borrowing needs of our customers, CoBank believes that fulfilling our mission also involves providing support to charitable causes in communities where we do business around the country. During 2010, the bank contributed more than \$1.3 million to non-profit organizations through its multi-faceted corporate citizenship program and made an additional \$1.9 million in commitments to charitable organizations for future years. Our program includes contributions directed by employees and members of our board, as well as strategic partnerships with organizations like the United Way, Food Bank of the Rockies, Komen for the Cure and Big Brothers Big Sisters. We also fund scholarships at a number of universities around the nation to support students studying agribusiness, cooperative finance and other disciplines with a direct tie to rural America. Finally, we have an ongoing initiative in place to improve the bank's enterprise-wide environmental performance.

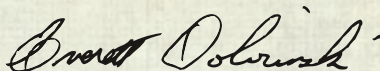
During the year, CoBank was recognized for these efforts with a "Partner in Philanthropy" award from the Denver Business Journal and

a "Champion of Hope" award from Mile High United Way. Our board continues to be extremely supportive of our citizenship program, and we're pleased to be in a position to give back to communities when the overall level of need remains so high.

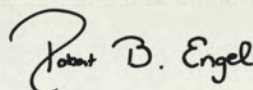
WELL POSITIONED FOR THE FUTURE

We know that the year 2011 will be full of both change and challenge for CoBank and all the businesses we serve in rural America's vital industries. Fortunately, we can depend on the leadership of a board that deeply understands the needs of our customers and the important role that CoBank plays in financing the nation's rural economy. Our commitment to our mission has never been stronger than it is today, and we look forward to a new year of growth and opportunity.

As always, we are deeply mindful of the enormous trust our customers place in CoBank as their financial partner. We thank you for your ongoing support and look forward to reporting back to you on our future progress.



Everett Dobrinski
Chairman



Robert B. Engel
President &
Chief Executive Officer

A close-up photograph of several green wheat stalks, showing the developing grains and long awns. The stalks are set against a blurred background of more green wheat. A dark grey L-shaped graphic element is overlaid on the image, starting from the top-left corner and extending towards the center.

AGRIBUSINESS

SCOTT DAU
General Manager
Leaf River

JANNA ROHRER
Relationship Manager
CoBank



LEAF RIVER AG SERVICES

Thirty-nine tornadoes blew through Minnesota on June 17, 2010 — a state record — leaving swathes of destruction across the state.

On that fateful day, employees at the Wadena location of Leaf River Ag Services had just enough time to hunker down in the office vault — a cinder block structure inside the co-op's main building — before a tornado smashed into the town of Wadena and leveled the offices of Leaf River Ag Services, a CoBank customer. Co-op employees had to hold the door closed while the raging twister passed.

"It made a noise like a freight train running right over us for about a minute," Retail Store Manager Rita Bahland recalled. "And then, dead quiet." The storm devastated Wadena, a town of 4,300, destroying and damaging dozens of homes and businesses.

Large portions of town were left treeless by the tornado's destructive winds.

When the storm passed, the tornado had blown debris against the vault door, and the Leaf River crew had to force the door open and muscle their way out. Fortunately, all five Leaf River employees emerged unharmed — and ready to get back to business.

One of their first calls was to CoBank, looking for vital equipment needed to deposit customer checks in their CoBank Cash Manager account. CoBank associates moved quickly to make sure the co-op had a new check-scanning machine the next day. Janna Rohrer, the CoBank relationship manager for Leaf River, even went to Wadena to help in the clean-up effort.

"We've always been impressed with the customer service and focus we get from the CoBank team," General Manager Scott Dau said. "But CoBank really went above and beyond after the tornado. That meant a lot."

Despite the lingering effects of the devastating tornado, Leaf River, with help from CoBank, has been able to keep the company's cash flowing in a positive direction. "Support from CoBank let us focus on taking care of our customers and rebuilding," Dau said. "We appreciate all the programs CoBank offers to businesses like ours during ordinary times — like our seasonal line of credit and Cash Manager services — but CoBank's support really means the most when times are tough."

**\$5.2
BILLION** : Year-over-year
: increase in
: agribusiness
: loan portfolio

**"CoBank's SUPPORT
MEANS THE MOST
WHEN TIMES
ARE TOUGH."**

: **2.2**
: **BILLION**
: **METRIC**
: **TONS**
Estimated global
consumption of
grains, 2010⁽¹⁾

REGIONAL AGRIBUSINESS BANKING GROUP

TOM HARMS
General Manager
RPA Farmers Cooperative

MILT WHIPPLE
Lead Relationship Manager
CoBank



RPA FARMERS CO-OP

In 2008, RPA Farmers Co-op found its grain bins full as lines of trucks piled high with corn waited to get into its three elevator locations west of Springfield, Illinois. General Manager Tom Harms knew the only solution was to add storage space to increase efficiency — and do it fast.

"We had a situation where we had greater demand for our space than we could accommodate," said Harms, an almost 40-year veteran of the grain industry. "We were forced to buy space at other locations, which was expensive, time consuming and not very efficient."

With financing from CoBank, RPA Farmers Co-op, which serves about 300 members, embarked on a major expansion of its Ashland, Illinois, grain elevator, adding a high-speed conveyor system and a

1-million-bushel grain bin. The project was completed in 2010 — just in time for harvest.

"Speed and efficiency are a primary reason farmers choose a country grain elevator for their storage needs," Harms said. "In the long run, we're much better having this new capacity on-site."

RPA considered other lenders when seeking funding for the project, but turned to CoBank for its deep knowledge of the grain industry. "We just didn't think any of the private banks really understood our business," Harms said. "We feel like CoBank is a partner that will be with us through good times and bad."



AGRIBUSINESS

JIM MATZAT
Lead Relationship Manager
CoBank

TIM KLEIN
President
National Beef

STEVE HUNT
Chief Executive Officer
U.S. Premium Beef

JAY NIELSEN
Chief Financial Officer
National Beef



U.S. PREMIUM BEEF/ NATIONAL BEEF

More than a decade ago, CoBank provided funding for the creation of U.S. Premium Beef, a unique marketing company that allows American cattle ranchers to retain ownership of the beef they produce from ranch to plate. Today, U.S. Premium Beef, through its ownership in National Beef, is one of the nation's leading marketers of beef to American consumers.

"CoBank's been an integral part of our success over the years, allowing us to sustain what we're doing and look at growth opportunities," Chief Executive Officer Steve Hunt said. "We couldn't do it without a lender that understands our industry and shares our vision of aligning beef producers all the way through to consumers."

It's an important banking relationship that extends through U.S. Premium Beef's various brands and lines of business. In 2010, CoBank

provided a major syndicated loan to National Beef, one of the nation's leading beef processing companies. U.S. Premium Beef has a controlling stake in National Beef; both companies are headquartered in Kansas City.

The two companies have seen solid financial performance over the last few years, thanks to an integrated business model that has helped insulate them from volatility in the commodities market and the recent economic downturn. Additionally, demand for beef and beef byproducts was strong overseas throughout 2010 and has been improving domestically. Working capital from CoBank gives U.S. Premium Beef and National Beef the financial flexibility to seize market opportunities, whether that's selling steaks to national restaurant chains or delivering hides to the Italian leather industry.

Tim Klein, president of National Beef, values CoBank's industry knowledge and financial capacity.

"We're very bullish on our industry," Klein said. "The U.S. is the only place on earth where you can produce high-quality cattle in any volume, and it is going to play a key role in meeting growing international demand. It gives us a lot of confidence to know we've got a partner like CoBank that will stand behind us through all business cycles and give us the opportunity to grow."

**\$4.6
BILLION** : Total export
: letters of credit
: handled by
: CoBank in 2010

**"IT GIVES US
A LOT OF CONFIDENCE
TO KNOW WE'VE GOT
A PARTNER
LIKE COBANK."**

Agricultural
products as a
percentage of all
U.S. exports⁽²⁾ : **11
PERCENT**

SCOTT TRAUTH
Lead Relationship Manager
CoBank

MICHAEL DOYLE
Chief Financial Officer
Foremost Farms

CATHLEEN REED
Capital Markets Manager
CoBank

DAVE FUHRMANN
President
Foremost Farms



FOREMOST FARMS USA

The data was clear: Per capita milk consumption was dropping while demand for milk byproducts — cheese, butter, yogurt, infant formula and pharmaceutical lactose — was on the rise.

With those trends in mind, Foremost Farms USA — the largest dairy cooperative headquartered in Wisconsin — made a difficult decision to sell its milk processing business and instead to focus on other strategic growth opportunities within the dairy industry. Foremost Farms needed capital to implement its bold shift in business strategy, and its executive team sought support from CoBank, the company's long-term lending partner.

A complex six-bank, syndicated financing transaction closed in 2010, and Foremost

Farms is now using the capital to embark on a major expansion of its mozzarella cheese and whey byproduct processing facilities. "These projects really accommodate the growth in milk supply we're seeing in northeastern and eastern Wisconsin and position us to meet the market demand that we have for our products," President Dave Fuhrmann said. "We believe we can be the best in the world in these market segments within the dairy industry."

Ultimately, the repositioning of Foremost Farms will be a significant boost for the cooperative's 2,000 dairy farmers, who have weathered some tough times in recent years. Under the cooperative business model, member-owners benefit from the broader cooperative's success. "These dairy farmers are the heart and soul of this company," Fuhrmann said.



STRATEGIC RELATIONSHIPS

MARK PEARCE
Senior Vice President
Farm Credit West

STEVE GILL
Co-Founder
Gills Onions

MARK NONNENMACHER
Regional President
CoBank

KEITH HESTERBERG
Regional Vice President
CoBank

BOB COX
Relationship Manager
Farm Credit West



**FARM CREDIT
WEST AND
GILLS ONIONS**

When Steve and David Gill founded their onion processing company back in 1983, the brothers only had one customer and a handful of employees working as peelers. Today, Gills Onions is the world's largest, providing over 80 million pounds of processed onions to restaurants, retailers and manufacturers of salsa, soups and spaghetti sauce out of a fully mechanized plant in Oxnard, California.

Recently, the company made headlines for a groundbreaking, environmentally advanced solution it came up with to manage facility waste. Traditionally, Gills had trucked most of its peels and other onion waste from the plant out to local fields for composting back into the soil. But that solution was costly and environmentally problematic given the fuel required and carbon emissions produced.

"As the plant grew, the waste problem grew," Steve Gill said. "I had no idea what to do with it."

Steve Gill conferred personally with engineers at the University of California-Davis and devised a plan to convert the onion waste into power using biomass technology. Gills Onions built a first-of-its-kind system through which bacteria in special tanks break down onion waste into methane, which is then converted into electricity via fuel cells. The system generates enough power to supply 100 percent of the baseload electricity consumed by the plant every year.

The \$9.5 million plant, financed by CoBank and Farm Credit West, has received an array of public accolades from the government, media and environmentally conscious

customers like McDonald's. It even beat out the new Dallas Cowboys football stadium for a first-place award from the American Council of Engineering Companies.

Steve Gill says Farm Credit is his lender of choice due to its longstanding commitment to and deep understanding of agriculture. "Farm Credit allows us to make decisions based on our own experience, and they stand by you in and out of market cycles," Gill said. "I value the relationship, and having bankers I can count on."

**\$15.3
BILLION**

• Commitments
• sold to Farm
• Credit System
• partners as of
• December 31,
• 2010

**"FARM CREDIT
STANDS BY YOU
IN AND OUT OF
MARKET CYCLES."**

Farmers,
ranchers and
other rural
borrowers served
by the Farm
Credit System⁽³⁾

500,000

STRATEGIC RELATIONSHIPS

TOM COSGROVE

Vice President of Commercial Lending
Farm Credit East

MARK LEACH

Chief Financial Officer
Atlantic Capes

DANIEL COHEN

President
Atlantic Capes

WILL BAILDON

Lead Relationship Manager
CoBank



FARM CREDIT EAST AND ATLANTIC CAPES FISHERIES

Atlantic Capes Fisheries is one of the largest scallop harvesters and processors on the East Coast, harvesting more than 10 million pounds of the succulent wild mollusks annually for distribution to customers across the U.S., Europe and Pacific Rim.

In 2010, CoBank, via its strategic relationship with Farm Credit East, provided Atlantic Capes with debt capital to finance operations and inventory. Atlantic Capes also takes advantage of CoBank's non-credit services, including cash management and export letters of credit.

"Financing from CoBank and Farm Credit East allows us to smoothly balance our seasonal harvest with year-round demand," said President Daniel Cohen. "Additionally, CoBank's export letters of credit are critical as we expand into international markets. CoBank and Farm

Credit East are good partners to Atlantic Capes Fisheries — they are focused on our business."

Mark Leach, chief financial officer for Atlantic Capes, believes the benefit of working with both Farm Credit organizations creates a competitive advantage. "The cash management service gives Atlantic Capes a tool to plan more effectively for the future because we have much greater efficiency in managing our cash flow," he said.

For Tom Cosgrove, vice president of commercial lending with Farm Credit East, being affiliated with CoBank is an important part of the value his association provides to Atlantic Capes. "Having a partner like CoBank helps ensure that we have the capacity to provide Atlantic Capes with both the financing and non-credit services the company needs."



RURAL INFRASTRUCTURE

DAN DASHO
General Manager
Cloverland Electric

ROBERT SCHALLIP
Board President
Cloverland Electric

LOIS KENNEY
Chief Financial Officer
Cloverland Electric

ERNIE MAAS
Director of Engineering
and Operations
Cloverland Electric

ANTHONY HILLIARD
Relationship Manager
CoBank



CLOVERLAND ELECTRIC COOPERATIVE

When Michigan-based Cloverland Electric Cooperative had the chance to acquire a local investor-owned utility, its executive team leapt at the opportunity. The transaction, which closed in 2010, was a good organizational fit and a solid business move, taking the cooperative from 19,000 to 42,000 subscribers without dramatically expanding its geographic footprint on Michigan's Upper Peninsula.

It also gave Cloverland ownership of a unique asset — the historic Edison Sault hydroelectric plant, which has served as a source of clean, renewable energy since 1902. The hydro plant is constructed from distinctive red-brown sandstone, and sits between Lake Superior and Lake Huron on the St. Marys River in Sault Ste. Marie, Michigan. Spanning a quarter-mile, it is the longest hydroelectric plant in the

world. With 74 turbines generating up to 30 megawatts of power, the plant was originally built to provide power for the nearby Union Carbide complex, but it was converted to serve the consumer market in 1964.

"This acquisition has been well received by our customers, creating some real efficiencies and allowing us to improve services across the board," General Manager Dan Dasho said. "In addition, owning Edison Sault allows us to lock in a long-term, low-cost renewable power supply and offer the benefits to all of our members."

Cloverland, which was founded in 1938 and today serves more islands than any other cooperative in the nation, selected CoBank to finance the acquisition. It was a competitive process, but Dasho said that CoBank's team

earned the business the old fashioned way — through a strong demonstration of customer service and deep industry knowledge.

"CoBank's team was incredibly responsive to us, which was important because this was a very complex acquisition and the negotiations were extremely fast-paced," Dasho said. "CoBank truly understood our needs and stepped forward to help us through this challenge. They were like a partner in the deal, and that was great for us."

33
PERCENT

CoBank Electric
Distribution
portfolio growth
in 2010

**"COBANK WAS
LIKE A PARTNER
IN THE DEAL,
AND THAT WAS
GREAT FOR US."**

Number of
people served
by U.S. electric
cooperatives⁽⁴⁾

42
MILLION

ELECTRIC DISTRIBUTION BANKING DIVISION

SHAWN DOLAN
Engineering Manager
Kootenai Electric

DOUG ELLIOTT
General Manager
Kootenai Electric

TERRY ROBINSON
Finance and Accounting Manager
Kootenai Electric



KOOTENAI ELECTRIC COOPERATIVE

Kootenai Electric Cooperative has been delivering power to customers in northwestern Idaho since 1938, historically purchasing electricity from the Bonneville Power Administration, which markets the power produced from an aging fleet of federally-owned dams on the Columbia River. But the pricing structure for that power has been changing, making it more expensive for KEC to grow and serve its customers.

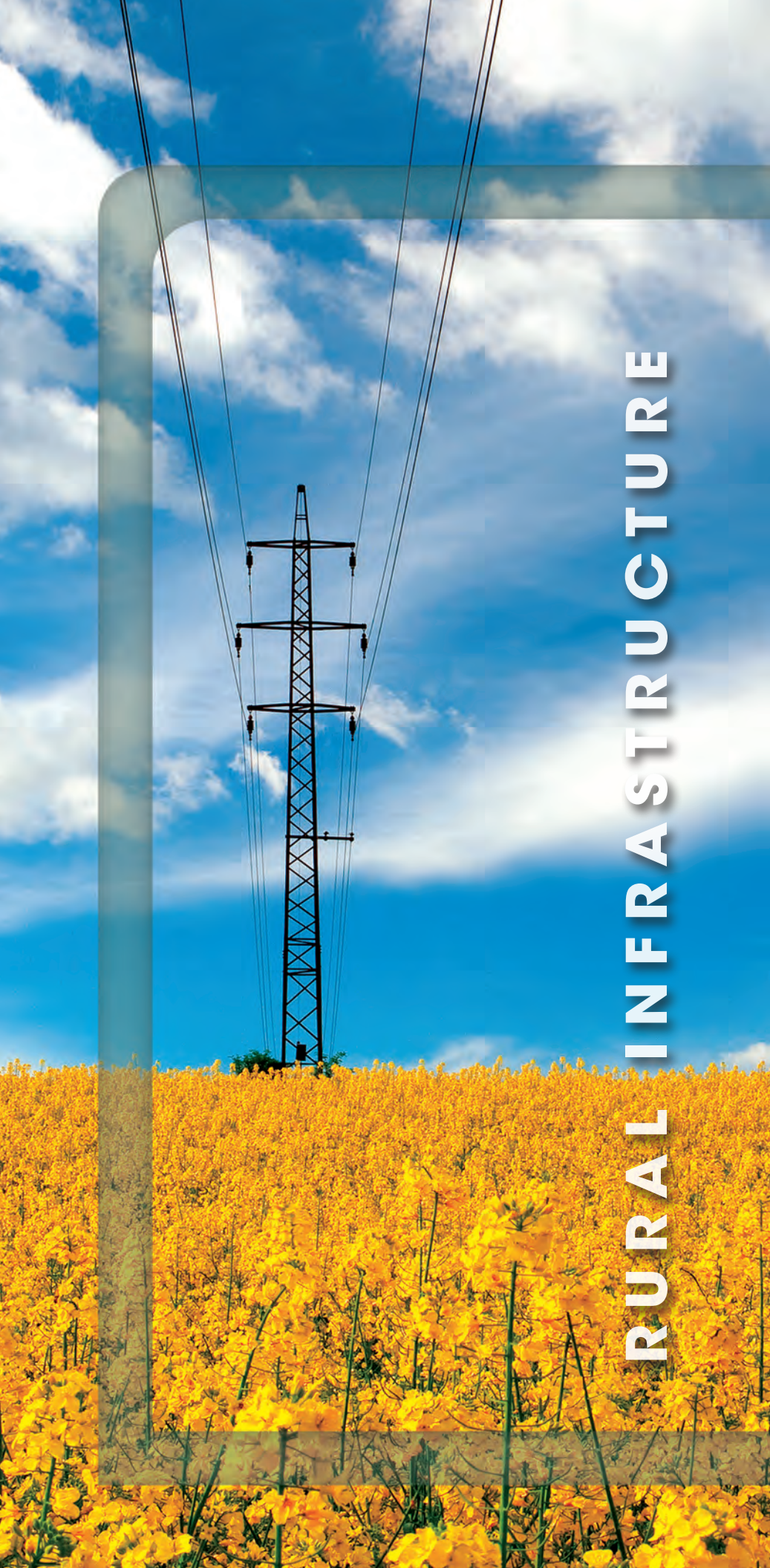
So KEC, a distribution cooperative serving 22,000 members in four counties, is getting into the power generation business. With support from CoBank, KEC in 2010 issued Clean Renewable Energy Bonds, or CREBs, for the Fighting Creek Landfill Gas Project. The new plant, operational in 2011, will capture waste methane — a greenhouse gas created

by the decomposition of trash that must be “flared” into the atmosphere — from a local landfill and convert it to an energy source.

“This was the first project KEC financed using CREBs,” General Manager Doug Elliott said. “CoBank’s assistance allowed us to maintain our focus on other aspects of the project and leave the complexities of the CREBs issuance to them. CoBank did a masterful job leading through this complex process.”

In the long run, the Fighting Creek project will deliver big benefits to KEC’s members. “This project is going to allow us to generate power for our members at a cost that is lower than we could purchase from others,” Elliot said.

“In addition, it’s good for the environment and supports our local community.”



RURAL INFRASTRUCTURE

DUANE HIGHLEY
Director of Power Production
Associated Electric Cooperative

DAVID McNABB
Chief Financial Officer
Associated Electric Cooperative

TODD TELESZ
Sector Vice President
CoBank



ASSOCIATED ELECTRIC COOPERATIVE

For the management team at Associated Electric Cooperative, it was a novel opportunity. Key components of a high efficiency, low-emissions natural gas power plant were sitting unused in the Arizona desert, and the company had an opportunity to acquire the assets at a substantial discount. With backing from CoBank, Associated Electric purchased the equipment and moved it to Pryor, Oklahoma, where the company is now using it to build a new, state-of-the-art power plant.

"Having the flexibility and certainty through our long-standing relationship with CoBank affirmed our confidence to make these moves to diversify our generation portfolio during a highly compressed time frame," Chief Financial Officer Dave McNabb said. "CoBank's people are focused on the customer, truly listening to us and working to meet our business needs."

The 540-megawatt Chouteau 2 power plant will go online in mid-2011, helping Associated Electric provide low-cost energy to 51 rural electric cooperatives and more than 875,000 customers in Missouri, Oklahoma and Iowa. Associated Electric's generation assets include four coal-based resources, three intermediate plants and four peaking natural gas plants.

Though coal-fired plants are still the least expensive source of electric power for the nation today, Associated Electric and many other utilities are increasingly turning to natural gas and other options as a hedge against uncertainty. "There are probably more unknowns in the power industry than there's ever been," Director of Power Production Duane Highley said. "If the market changes and we need natural gas to produce more and more power,

then we're well positioned to do that at the lowest cost to our owners."

In addition to providing funding for construction of the new plant, CoBank is Associated Electric's No. 1 source for operating capital and liquidity. The benefit of ownership provided through the cooperative model is an important factor for Associated Electric. "Our goal is to save a dollar for somebody at the end of the line and make a difference in their life, and keeping their power affordable is a pretty big deal," McNabb said. "We live the co-op model, so doing business with people who also live it, like CoBank, is extremely beneficial."

46
PERCENT

- Increase in financing for renewable energy projects by CoBank in 2010

**"CoBank's
TEAM WAS
INCREDIBLY
RESPONSIVE
TO US."**

New electric generation capacity coming online in the U.S. through 2014⁽⁹⁾

72,157
MEGAWATTS

ENERGY & WATER BANKING DIVISION

GARY SPIELMAN

Vice President of Administration
Minnkota Power

JOHN KEMPER

Lead Relationship Manager
CoBank

DAVID LOER

President and
Chief Executive Officer
Minnkota Power



MINNKOTA POWER COOPERATIVE

Minnkota Power Cooperative plans for the long-term. In early 2010, the North Dakota-based company sold 465 miles of transmission lines to an adjacent utility in exchange for a 100 percent stake in a coal-fired power plant. The strategic transaction secured a lasting source of low-cost energy for Minnkota, which serves more than 116,000 customers in eastern North Dakota and northwestern Minnesota.

"This deal eliminated our need to build a new power plant, which can be difficult, time-consuming and expensive," said Dave Loer, Minnkota president and chief executive officer. "In conjunction with our renewable power, it solidifies our generation resources until 2030."

But in order to tap the increased share of megawatts from the plant, Minnkota needed

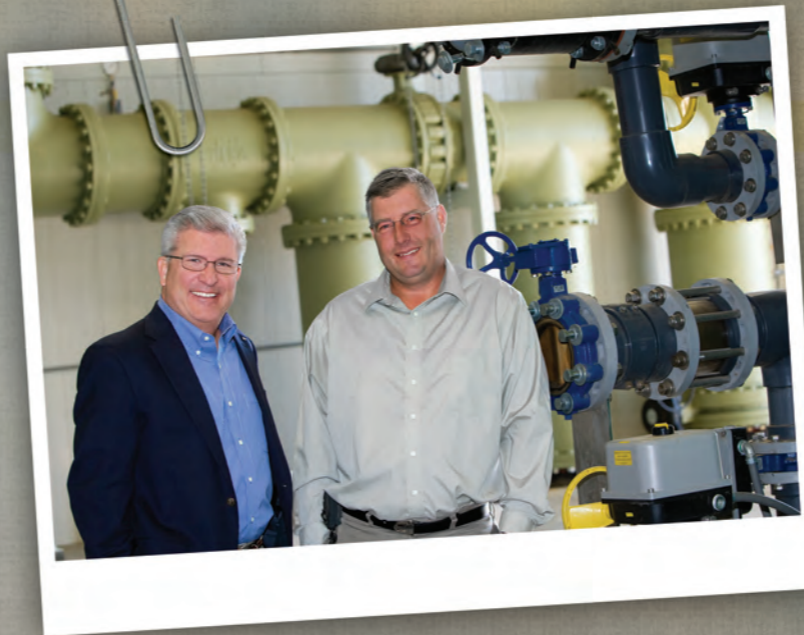
to upgrade its transmission facilities. With bridge financing from CoBank, Minnkota is moving ahead with construction of a 250-mile, 345-kilovolt transmission line that will connect the plant near Center, North Dakota, with population centers in the Red River Valley. The project is slated to be complete in 2013.

With a banking relationship that dates back more than two decades, it was natural for Minnkota Power to turn to CoBank for financial backing.

"The deal went very smoothly," Loer said. "We were pleased with the customer service, interest rate and flexibility. We particularly appreciate the patronage, which we factor into our estimated cost of borrowing. It is part of what has made CoBank's deals so attractive."



RURAL INFRASTRUCTURE



STEVE GUSTAFSON
Sector Vice President
CoBank

RANDY IEDEMA
General Manager
Rural Water System No. 1

**RURAL WATER
SYSTEM NO. 1**

Rural Water System No. 1 serves only 1,260 accounts in northwestern Iowa, but those customers include residents of two small communities, an ethanol plant, meat packing facilities and more than 15 million thirsty head of livestock — dairy cows, hogs, poultry and even dog breeders.

"With all that livestock, it's not uncommon, when the temperature reaches over 85 degrees, for us to double our water usage in a day," General Manager Randy Iedema said. "That stresses the system. We need more capacity and more flexibility. We can't just be sitting here hoping we have enough water; we need a backup so our residents and livelihoods can be sustained."

Working in partnership with CoBank and the U.S. Department of Agriculture, Iedema created a strategic plan to dramatically

increase the system's capacity by purchasing 300 acres of land for a new well field and more than doubling the size of one of the system's water treatment plants. The project, to be completed in 2011, allows Rural Water System No. 1 to tap different aquifers, creating a new supply of water that gives the system flexibility to meet the demands of local customers under any conditions.

CoBank has been providing financial services to Rural Water System No. 1 since 2000, but this was Iedema's first experience with the bank in his role as general manager, a title he assumed in 2008. For him, CoBank's industry knowledge and customer focus were keys to the project's success.

"CoBank has been very willing to work with me and help me learn about the banking system,"

he said. "It all went much smoother than I expected. In the end, CoBank helped ensure that the families Rural Water System No. 1 serves have the best quality and affordability that we can give them on a daily basis, which is critical to the lifestyle of everyone here in northwest Iowa."

U.S. water systems serving communities of less than 10,000[®]

47,495

"WE REALLY

APPRECIATE OUR

DEPENDABLE

RELATIONSHIP

WITH CoBank."

CoBank :
water and :
wastewater loan :
commitment :
growth, :
2006-2010 :

**15
PERCENT**

ENERGY & WATER BANKING DIVISION

DAVID DORNBIRER
Lead Relationship Manager
CoBank

DAVID SPACHT
Chief Financial Officer
Artesian Resources

DIAN TAYLOR
Chief Executive Officer
and President
Artesian Resources



ARTESIAN RESOURCES

With a history that dates back more than 105 years, Artesian Resources is one of the largest investor-owned water companies in the nation and a longtime CoBank customer. Today, the Delaware-based company supplies 7.5 billion gallons of water to 76,000 metered customers via a network of water mains that extends over 1,000 miles throughout three Mid-Atlantic states.

Growth is a big issue for Artesian Resources, which serves communities in Delaware, Maryland and Pennsylvania. For instance, Maryland's Cecil County is seeing an explosion of new development due to an expansion of local military facilities.

Artesian has had to expand as an organization to accommodate growth in its service territory. But until recently, the company didn't have

enough office space for its more than 270 employees. With financing from CoBank, Artesian Resources constructed a new, state-of-the-art office building on its Newark, Delaware, campus in 2010. In addition to plenty of room for offices and meetings, the new building boasts high-tech data and operations centers that allow the company to monitor and control various aspects of its water systems remotely.

"We've doubled or tripled our size over the years and grew out of our space," Chief Financial Officer David Spacht said. "The new complex enables us to be more efficient and provide better customer service. We really appreciate our dependable relationship with CoBank."



RURAL INFRASTRUCTURE

ADELE SKOLITS :
Chief Financial Officer :
Shentel :

LISA CRADY :
Senior Relationship Manager :
CoBank :

CHRIS FRENCH :
President and :
Chief Executive Officer :
Shentel :

EARLE MACKENZIE :
Chief Operating Officer :
Shentel :

GLORIA HANCOCK :
Senior Relationship Manager :
CoBank :



SHENANDOAH TELECOMMUNICATIONS COMPANY

The Shenandoah Valley — bound by the Blue Ridge Mountains on the east and the Appalachian Mountains on the west — boasts some of the most dramatic scenery in the eastern United States. But the region's famous gaps and hollows present huge challenges for communications service providers.

"Many of our customers are located down in the valleys and are surrounded by mountains," said Adele Skolits, chief financial officer for Shenandoah Telecommunications, or Shentel. "These areas are typically underserved due to the high cost of providing telecommunication services."

Shentel is a publically-traded communications company based in Edinburg, Virginia, providing wireline, wireless and cable communications solutions to customers in the Shenandoah

Valley. In 2010, Shentel's acquisition of the assets of a local rural cable operator positioned the company to address the challenge of delivering triple-play voice, high-speed Internet and television services to underserved rural markets in southern Virginia and southern West Virginia. In addition, the acquisition meant that Shentel picked up nearly 43,000 new customers. CoBank led a syndicated transaction — involving five commercial banks and 12 Farm Credit institutions — that Shentel used to finance the acquisition and refinance existing loans.

"We have a clear strategy of sticking to our knitting, which means focusing on serving rural areas," Skolits said. "With the completion of the acquisition, we've been able to expand our service offerings and to experience gains in customers and revenues. It truly positions Shentel to continue delivering

vital communications services to rural customers and also to experience strong growth across the board for the company."

Shentel's longstanding relationship with CoBank allowed the company's leadership to move with confidence, secure in knowing they could depend on CoBank to meet their financial needs.

"CoBank really knows us and our business," Skolits said. "They have the proven ability to bring the right partner banks on board and the capacity to ensure we get the right financing. We appreciate that CoBank was able to structure a deal that works so well for Shentel, our board and our customers — now and for the future."

54.1 : Percentage
PERCENT : of rural U.S.
: households with
: a broadband
: connection⁽⁷⁾

**“COBANK HAS THE
ABILITY TO BRING
THE RIGHT PARTNERS
ON BOARD AND THE
CAPACITY TO ENSURE WE
GET THE RIGHT FINANCING.”**

Total :
communications :
loan commitments :
for CoBank, 2010 : **\$4.7
BILLION**

STEVE SACKRIDER
General Manager
WTC Communications

ANDY SMITH
Lead Relationship Manager
CoBank



WAMEGO TELECOMMUNICATIONS COMPANY, INC.

Kansas-based Wamego Telecommunications Company, Inc. first began providing telephone service to rural customers in 1912. Over the last century, the independent telephone company has maintained a tradition of investing in new technology to better serve its customers.

Several years ago, WTC's leadership foresaw that high-speed internet would become a cornerstone of their business. The company built one of the first fiber-to-the-home networks in rural America, which today serves about half of WTC's service territory. But WTC wanted to finish what it started, and in 2010 the company approached CoBank for financing to complete its fiber-to-the-home network.

Industry knowledge and a focus on WTC's financial needs made CoBank the natural choice, and the CoBank team completed a

new term loan for WTC in just a few months.

"CoBank's ability to help us get the financing done quickly allowed us to focus on getting equipment in the ground and sped up our ability to get this project launched and delivered to our customers," WTC General Manager Steve Sackrider said.

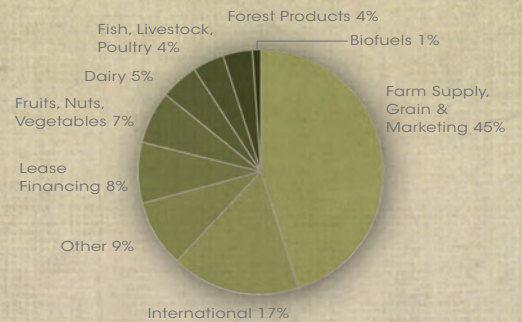
As the communications provider gets closer to finishing its fiber-to-the-home network, WTC is way ahead of the game, both financially and technologically. "This is key to the future for us," Sackrider said. "When this project is complete, more of our rural customers will have access to services like high-speed internet and advanced cable TV."

INDUSTRY PORTFOLIOS

CoBank ended 2010 with total loan volume of \$50.0 billion. For a detailed discussion and analysis of the bank's 2010 financial performance, see the financial section of this report starting on page 25.

AGRIBUSINESS

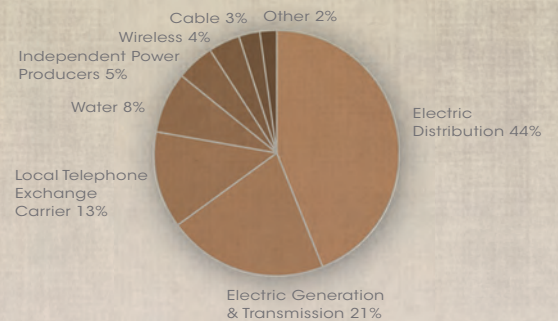
The Agribusiness segment includes the Regional Agribusiness Banking Group, Corporate Agribusiness Banking Group and Banking Services Group, which includes Farm Credit Leasing. It serves cooperatives and other customers involved in a wide variety of industries, including grain handling and marketing, farm supply, food processing, dairy, livestock, fruits, nuts, vegetables, cotton, biofuels and forest products. Average loan volume in the Agribusiness portfolio was \$18.9 billion in 2010.



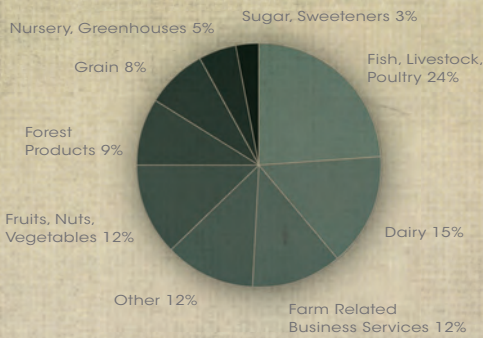
YEAR-END LOAN VOLUME BY INDUSTRY

RURAL INFRASTRUCTURE

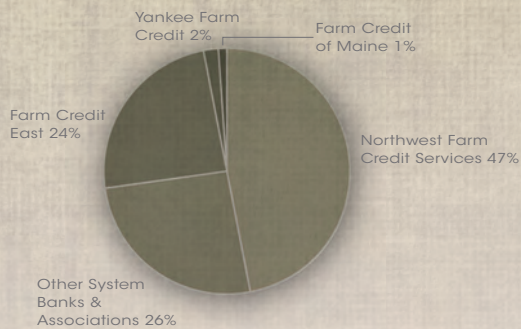
The Rural Infrastructure segment includes the Electric Distribution Banking Division, Energy & Water Banking Division and Communications Banking Division. It serves rural utilities and other customers across a wide variety of industries, including electric generation, transmission and distribution cooperatives; water and wastewater companies; and wireline, cable and wireless communications service providers. Average loan volume in CoBank's Rural Infrastructure portfolio was \$11.5 billion in 2010.



YEAR-END LOAN VOLUME BY INDUSTRY



YEAR-END LOAN VOLUME BY INDUSTRY AND INSTITUTION



STRATEGIC RELATIONSHIPS

Through its Strategic Relationships operating segment, CoBank serves as a wholesale provider of funds to four affiliated Farm Credit associations: Northwest Farm Credit Services, Farm Credit East, Yankee Farm Credit and Farm Credit of Maine. CoBank also serves as a partner of choice for a number of other Farm Credit banks and associations, via loan participations and syndications and through providing cash management, treasury products and other non-credit services. Average loan volume in this portfolio was \$15.1 billion in 2010.

FOOTNOTES

1. SOURCE: U.S. Department of Agriculture, World Agricultural Outlook Board, World Agricultural Supply and Demand Estimates. Agricultural commodity prices surged in late 2010 and early 2011, due to a combination of rising global demand and historically low stockpiles of grain and oilseeds.
2. SOURCE: U.S. Census Bureau, Statistical Abstract of the United States: 2011. In 2009, the value of all U.S. exports totaled \$1.6 trillion, with all U.S. agricultural products making up 11 percent of the total.
3. SOURCE: Farm Credit System. The Farm Credit System is the nation's largest lender dedicated exclusively to agriculture and rural communities. Currently the system serves an estimated 500,000 qualified member-borrowers nationwide.
4. SOURCE: National Rural Electric Cooperative Association. There are 846 electric distribution cooperatives and 66 generation and transmission cooperatives serving 42 million people in 47 states, including 18 million businesses, homes, schools, churches, farms, irrigation systems and more.
5. SOURCE: U.S. Energy Information Administration, Electric Power Industry 2009: Year in Review. As of the end of 2009, electric power producers planned to add 72,157 MW of capacity between 2010 and 2014. Of this, 48.3 percent is planned to be fired by natural gas and 23.1 percent from coal.
6. SOURCE: U.S. Environmental Protection Agency, FACTOIDS: Drinking Water and Ground Water Statistics for 2009. There are approximately 52,000 community water systems nationwide, but just 8 percent of those systems serve 82 percent of the U.S. population. The remaining community water systems — 47,495 — serve communities with a population of 10,000 or less.
7. SOURCE: U.S. Department of Commerce, National Telecommunication Information Administration, DIGITAL NATION: 21st Century America's Progress Toward Universal Broadband Internet Access. A survey of more than 50,000 U.S. households found that Americans living in rural areas are less likely to have access to broadband internet than their urban counterparts.

COBANK 2010 FINANCIAL REPORT

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OUR VALUE PROPOSITION

COBANK IS A FINANCIALLY STRONG, DEPENDABLE,
COOPERATIVE BANK THAT PROVIDES CREDIT AND
FINANCIAL SOLUTIONS TO RURAL AMERICA'S BUSINESSES.
WE ARE KNOWLEDGEABLE, RESPONSIVE AND COMMITTED
TO ENHANCING OUR CAPACITY TO DELIVER SUPERIOR
CUSTOMER SERVICE AND COMPETITIVELY PRICED
PRODUCTS, WHILE MAINTAINING THE SAFETY AND
SOUNDNESS OF THE BANK FOR FUTURE GENERATIONS.
WE CONSISTENTLY DEMONSTRATE OUR FOCUS ON RURAL
AMERICA, REPEATEDLY STRIVE TO BE A TRUSTED ADVISOR
FOR OUR CUSTOMERS AND PROVIDE A CONSISTENT RETURN
ON THEIR INVESTMENT AND OWNERSHIP IN CoBANK.



Five-Year Summary of Selected Consolidated Financial Data

CoBank, ACB

(\$ in Thousands)

| | 2010 | 2009 | 2008 | 2007 | 2006 |
|---|----------------------|----------------------|----------------------|----------------------|----------------------|
| Consolidated Income Statement Data | | | | | |
| Net Interest Income | \$ 950,845 | \$ 945,963 | \$ 862,609 | \$ 645,440 | \$ 524,812 |
| Provision (Reversal) for Loan Losses | 60,000 | 80,000 | 55,000 | (5,000) | 4,000 |
| Noninterest Income | 98,559 | 84,961 | 68,411 | 47,839 | 54,110 |
| Operating Expenses | 216,210 | 219,231 | 215,181 | 185,467 | 166,893 |
| Provision for Income Taxes | 159,427 | 166,277 | 127,406 | 97,202 | 73,512 |
| Net Income | \$ 613,767 | \$ 565,416 | \$ 533,433 | \$ 415,610 | \$ 334,517 |
| Net Income Distributed | | | | | |
| Patronage Distributions: | | | | | |
| Common Stock | \$ 90,450 | \$ 85,067 | \$ 106,681 | \$ 87,794 | \$ 66,477 |
| Cash | 194,110 | 183,828 | 207,216 | 156,949 | 126,459 |
| Total Patronage Distributions | 284,560 | 268,895 | 313,897 | 244,743 | 192,936 |
| Preferred Stock Dividends | 63,799 | 60,955 | 48,075 | 37,442 | 37,442 |
| Total Net Income Distributed | \$ 348,359 | \$ 329,850 | \$ 361,972 | \$ 282,185 | \$ 230,378 |
| Consolidated Balance Sheet Data | | | | | |
| Total Loans | \$ 49,992,338 | \$ 44,174,464 | \$ 44,550,121 | \$ 40,491,486 | \$ 33,076,498 |
| Less: Allowance for Loan Losses | 400,744 | 369,817 | 329,198 | 447,226 | 438,231 |
| Net Loans | 49,591,594 | 43,804,647 | 44,220,923 | 40,044,260 | 32,638,267 |
| Investment Securities | 12,616,696 | 11,808,207 | 11,536,848 | 10,434,371 | 7,462,450 |
| Cash, Federal Funds Sold, Securities Purchased Under Resale Agreements and Other | 1,922,586 | 928,083 | 3,132,204 | 687,815 | 674,520 |
| Other Assets | 1,695,014 | 1,619,765 | 2,272,082 | 1,022,450 | 603,855 |
| Total Assets | \$ 65,825,890 | \$ 58,160,702 | \$ 61,162,057 | \$ 52,188,896 | \$ 41,379,092 |
| Debt Obligations with Maturities ≤ 1 Year | \$ 22,271,349 | \$ 16,593,682 | \$ 19,404,201 | \$ 16,083,564 | \$ 14,296,117 |
| Debt Obligations with Maturities ≥ 1 Year | 38,052,964 | 36,317,632 | 36,961,221 | 31,980,178 | 23,137,406 |
| Reserve for Unfunded Commitments | 99,799 | 128,373 | 154,223 | n/a | n/a |
| Other Liabilities | 995,581 | 1,063,386 | 1,047,563 | 891,730 | 905,511 |
| Total Liabilities | 61,419,693 | 54,103,073 | 57,567,208 | 48,955,472 | 38,339,034 |
| Preferred Stock | 700,000 | 700,000 | 700,000 | 500,000 | 500,000 |
| Common Stock | 1,568,989 | 1,520,054 | 1,401,192 | 1,291,421 | 1,242,438 |
| Unallocated Retained Earnings | 2,137,394 | 1,871,986 | 1,638,596 | 1,470,191 | 1,337,016 |
| Accumulated Other Comprehensive Loss | (186) | (34,411) | (144,939) | (28,188) | (39,396) |
| Total Shareholders' Equity | 4,406,197 | 4,057,629 | 3,594,849 | 3,233,424 | 3,040,058 |
| Total Liabilities and Shareholders' Equity | \$ 65,825,890 | \$ 58,160,702 | \$ 61,162,057 | \$ 52,188,896 | \$ 41,379,092 |
| Key Financial Ratios | | | | | |
| For the Year: | | | | | |
| Return on Average Common Shareholders' Equity | 15.31 % | 15.96 % | 17.32 % | 14.64 % | 12.57 % |
| Return on Average Total Shareholders' Equity | 14.30 | 14.65 | 15.65 | 13.48 | 11.68 |
| Return on Average Assets | 1.03 | 0.93 | 0.91 | 0.93 | 0.92 |
| Net Interest Margin | 1.66 | 1.66 | 1.51 | 1.45 | 1.45 |
| Net (Charge-offs) Recoveries / Average Loans | (0.13) | (0.15) | (0.04) | 0.04 | (0.01) |
| Patronage Distributions / Total Average Common Stock Owned by Active Borrowers | 19.77 | 19.68 | 25.10 | 20.89 | 18.17 |
| At Year-end: | | | | | |
| Debt / Total Shareholders' Equity (: 1) | 13.94 | 13.33 | 16.01 | 15.14 | 12.61 |
| Total Shareholders' Equity / Total Assets | 6.69 % | 6.98 % | 5.88 % | 6.20 % | 7.35 % |
| Reserve for Credit Exposure ^(a) / Total Loans | 1.00 | 1.13 | 1.09 | 1.10 | 1.32 |
| Permanent Capital Ratio | 14.30 | 15.29 | 14.75 | 12.14 | 11.43 |
| Total Surplus Ratio | 13.96 | 15.01 | 14.61 | 12.14 | 11.43 |
| Core Surplus Ratio | 8.42 | 8.77 | 7.98 | 4.94 | 5.13 |
| Net Collateral Ratio | 108.03 | 108.67 | 107.75 | 107.09 | 107.14 |

^(a) Includes the allowance for loan losses and the reserve for unfunded commitments

Management's Discussion and Analysis

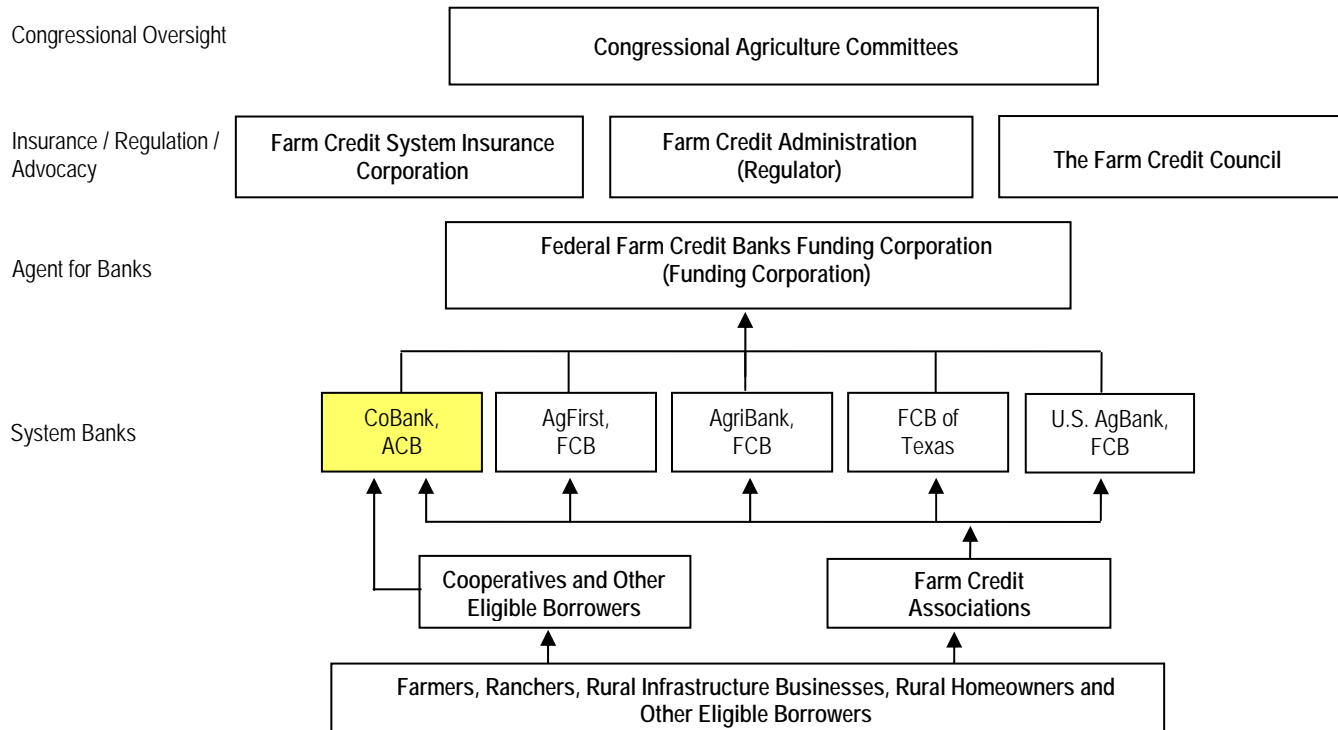
CoBank, ACB

Company Introduction

CoBank, ACB (CoBank or the Bank) is one of the five banks of the Farm Credit System (System). CoBank provides loans, leases and other financial services to vital industries across rural America. The System is a federally chartered network of borrower-owned lending institutions composed of cooperatives and related service organizations.

Cooperatives are organizations that are owned and controlled by their members, who use the cooperative's products, supplies or services. The System was established in 1916 by the United States Congress, and is a Government Sponsored Enterprise (GSE).

The following chart depicts the overall structure and ownership of the System.



System annual and quarterly information statements and press releases for the current fiscal year and the two preceding fiscal years, as well as offering circulars relating to System debt securities, are available for inspection at, or will be furnished without charge upon request to, the Federal Farm Credit Banks Funding Corporation, 10 Exchange Place, Suite 1401, Jersey City, New Jersey 07302; telephone (201) 200-8000. These documents are also available online through the Federal Farm Credit Banks Funding Corporation website at www.farmcredit-ffcb.com. This website also provides a link to each System bank's website where financial and other information of each bank can be found. Similar links are also available at the CoBank website at www.cobank.com.

We are federally chartered under the Farm Credit Act of 1971, as amended (the Farm Credit Act), and are subject to supervision, examination, and safety and soundness regulation by an independent federal agency, the Farm Credit Administration (FCA). We are restricted to making loans and providing related financial services to eligible borrowers in the

agribusiness and rural utility industries, and to certain related entities, as defined by the Farm Credit Act. We are not legally authorized to accept deposits. We raise debt funds for our operations primarily through participating in the issuance of debt securities by the System's Federal Farm Credit Banks Funding Corporation (Funding Corporation).

We are cooperatively owned by our U.S. customers, who consist of agricultural cooperatives, rural energy, communications and water companies, farmer-owned financial institutions including Agricultural Credit Associations (Associations) and other businesses that serve rural America. We are the primary funding source for Associations serving specified geographic regions in the northwestern and northeastern United States (which are regulated financial institutions and members of the System). We collectively refer to these entities as our affiliated Associations.

We provide a diversified range of financial services domestically and internationally to vital industries through three operating segments: Agribusiness, Strategic Relationships and Rural Infrastructure.

Overview

CoBank recorded another year of strong financial performance in 2010, despite persistently sluggish conditions in the broader economy. Our earnings grew to \$613.8 million in 2010, a 9 percent increase compared to 2009. Our 2010 earnings included the benefit of refunds of Farm Credit insurance fund premiums paid in prior years, a decrease in current year Farm Credit insurance fund premiums, greater fee income and a lower provision for loan losses. In addition, net interest income increased slightly. These positive factors were somewhat offset by impairment losses in our investment portfolio and costs related to the settlement of a business dispute. Average loan volume increased by \$1.0 billion, or 2 percent, in 2010 primarily due to a sharp rise in prices for certain agricultural commodities in the latter half of the year that drove increased borrowing by agribusiness customers, as well as growth in loans to rural energy customers. The rise in commodity prices also led to increased period-end loan volume, which grew to \$50.0 billion at December 31, 2010 as compared to \$44.2 billion one year ago.

Our financial position remains solid as of the end of 2010, reflecting strong levels of capital and liquidity. We are well capitalized, with \$4.4 billion in shareholders' equity. Our permanent capital and core surplus ratios were 14.30 percent and 8.42 percent, respectively, as of December 31, 2010, both well in excess of minimum regulatory requirements. As of year-end 2010, we held \$14.5 billion in investments and cash as a liquidity reserve and our days liquidity averaged 240 days in 2010, also well in excess of the regulatory minimum of 90 days.

The overall credit quality in our loan portfolio improved in 2010, which was reflected across a number of credit quality indicators. Adverse assets declined to 1.71 percent of total loans and related accrued interest at December 31, 2010, compared to 2.17 percent at December 31, 2009. Nonaccrual loans decreased to \$167.0 million at December 31, 2010 from \$307.6 million at December 31, 2009. We recorded a \$60.0 million provision for loan losses in 2010, which approximated our net charge-offs of \$57.6 million. Our reserve for credit exposure, which includes our allowance for loan losses and our reserve for unfunded commitments, totaled \$500.5 million at year-end.

Weakness in the housing sector and overall economy continues to impact the credit quality of our investment portfolio. As a result, we recorded \$44.0 million in impairment losses in 2010 related to certain investment securities. Notwithstanding these losses, the overall credit quality of this portfolio is strong, as approximately 96 percent of our investment securities are guaranteed by the U.S. government or issued by a GSE.

Our diversified loan portfolio, which within the context of our mission includes loans to borrowers in the agribusiness and rural utility industries, along with our prudent approach to risk management, has enabled us to achieve consistently strong financial performance during this prolonged period of economic weakness. We remain well positioned to continue fulfilling our mission and serving as a stable and dependable source of financing for our customers.

As discussed on page 57, in late 2010, the boards of directors for CoBank and U.S. AgBank, FCB, one of the other four System banks, unanimously approved a Letter of Intent to pursue a merger. The Letter of Intent sets forth the key terms and conditions of the proposed transaction. Any such merger is subject to the approval of both banks' stockholders and the FCA.

Results of Operations

Our 2010 earnings grew to \$613.8 million compared to \$565.4 million in 2009. Increased earnings were driven principally by the refunds of Farm Credit insurance fund premiums paid in prior years and a lower insurance fund premium assessment in the current year, which more than offset impairment losses in our investment securities portfolio and costs related to the settlement of a business dispute. In addition, net interest income and fees were higher in 2010 and the improving credit quality of our loan portfolio led to a lower provision for loan losses. Our return on average common shareholders' equity decreased to 15.31 percent for 2010 from 15.96 percent in 2009. This decrease primarily resulted from capital growth due to strong 2009 and 2010 earnings. Our return on average assets increased to 1.03 percent for 2010, as compared to 0.93 percent for 2009, due primarily to higher noninterest income and a lower provision for loan losses.

Our 2009 net income increased to \$565.4 million, or 6 percent, from \$533.4 million in 2008. The 2009 increase was principally driven by an \$83.4 million increase in net interest income that resulted largely from our balance sheet positioning, which benefited from the steepened yield curve environment that emerged during the global economic downturn. A \$38.9 million increase in income taxes and a \$25.0 million increase in the provision for loan losses partially offset the growth in net interest income in 2009.

Average Balances and Rates

| Year Ended December 31, | 2010 | | | 2009 | | | 2008 | | |
|---|------------------|--------------|-------------------------|------------------|--------------|-------------------------|------------------|--------------|-------------------------|
| (\$ in Millions) | Average Balance | Average Rate | Interest Income/Expense | Average Balance | Average Rate | Interest Income/Expense | Average Balance | Average Rate | Interest Income/Expense |
| Interest-earning Assets | | | | | | | | | |
| Total Loans | \$ 45,538 | 3.09 % | \$ 1,408 | \$ 44,527 | 3.25 % | \$ 1,447 | \$ 45,374 | 4.71 % | \$ 2,138 |
| Investment Securities | 11,618 | 2.22 | 258 | 12,360 | 2.66 | 329 | 11,136 | 4.07 | 453 |
| Other Earning Assets | - | - | - | 33 | - | - | 620 | 1.94 | 12 |
| Total Interest-earning Assets | \$ 57,156 | 2.91 | \$ 1,666 | \$ 56,920 | 3.12 | \$ 1,776 | \$ 57,130 | 4.56 | \$ 2,603 |
| Interest-bearing Liabilities | | | | | | | | | |
| Bonds and Notes | \$ 48,804 | 1.35 % | \$ 660 | \$ 51,382 | 1.48 % | \$ 763 | \$ 49,437 | 3.20 % | \$ 1,582 |
| Discount Notes | 3,009 | 0.27 | 8 | 1,960 | 1.22 | 24 | 3,161 | 2.82 | 89 |
| Subordinated Debt | 1,000 | 4.50 | 45 | 1,000 | 4.80 | 48 | 852 | 5.52 | 47 |
| Other Notes Payable | 1,525 | 0.13 | 2 | 1,689 | (0.30) * | (5) * | 797 | 2.89 | 22 |
| Total Interest-bearing Liabilities | \$ 54,338 | 1.31 | \$ 715 | \$ 56,031 | 1.48 | \$ 830 | \$ 54,247 | 3.21 | \$ 1,740 |
| Interest Rate Spread | | 1.60 | | | 1.64 | | | 1.35 | |
| Impact of Equity Financing | \$ 4,292 | 0.06 | | \$ 3,861 | 0.02 | | \$ 3,415 | 0.16 | |
| Net Interest Margin and | | | | | | | | | |
| Net Interest Income | | 1.66 % | \$ 951 | | 1.66 % | \$ 946 | | 1.51 % | \$ 863 |

* Amounts are negative for 2009 due to changes in the fair values of derivatives. See "Liquidity and Capital Resources - Derivatives" on page 52.

Net Interest Income

Changes in our interest income, interest expense and net interest income due to volume and rate variances for the major categories of interest-earning assets and interest-bearing liabilities shown in the table above are summarized in the

following table. The change in interest income or expense not solely due to changes in volume or rates has been allocated in proportion to the absolute dollar amount of the change in volume and rate.

Changes in Net Interest Income Due to Changes in Average Volume and Interest Rates

| (\$ in Millions) | 2010 | | | 2009 | | |
|---------------------------------------|---|----------------|--------------|---|---------------|--------------|
| | Increase (Decrease) From Previous Year Due To | | | Increase (Decrease) From Previous Year Due To | | |
| | Volume | Yield/Rate | Total | Volume | Yield/Rate | Total |
| Total Loans | \$ 33 | \$ (72) | \$ (39) | \$ (40) | \$ (651) | \$ (691) |
| Investment Securities | (19) | (52) | (71) | 46 | (170) | (124) |
| Other Earning Assets | - | - | - | (6) | (6) | (12) |
| Total Interest Income | 14 | (124) | (110) | - | (827) | (827) |
| Bonds and Notes | (39) | (64) | (103) | 64 | (883) | (819) |
| Discount Notes | 9 | (25) | (16) | (26) | (39) | (65) |
| Subordinated Debt | - | (3) | (3) | 8 | (7) | 1 |
| Other Notes Payable | - | 7 | 7 | 11 | (38) | (27) |
| Total Interest Expense | (30) | (85) | (115) | 57 | (967) | (910) |
| Changes in Net Interest Income | \$ 44 | \$ (39) | \$ 5 | \$ (57) | \$ 140 | \$ 83 |

Net interest income increased slightly to \$950.8 million in 2010, compared to \$946.0 million in 2009. The 1 percent increase in net interest income resulted from an increase in average loan volume, particularly in loans to agribusiness customers, and higher lending spreads in most of our lending portfolios. These factors were mostly offset by a decreased benefit to our asset/liability position and lower spreads earned on our investment portfolio, both of which are described below.

Notwithstanding the aforementioned increase in lending spreads in most of our lending portfolios, which are reflective of current market conditions, net interest margin for 2010 remained unchanged from 2009 at 1.66 percent. Our overall interest rate spread decreased slightly to 1.60 percent from 1.64 percent. This decrease is primarily the result of a reduced benefit to our asset/liability position of low short-term market interest rates, as the slope of the yield curve was more positive in 2009. Our asset/liability position is further discussed in “Interest Rate Risk Management” beginning on page 42. In addition, the 2009 period included a benefit from the change in the fair value of derivatives, as explained in “Liquidity and Capital Resources – Derivatives” on page 52. Lower rates earned on our investment portfolio, in part due to higher balances of U.S. Treasury securities beginning in the latter half of 2009, also contributed to a lower overall interest rate spread in 2010. Our investment portfolio is primarily held for liquidity purposes, and generally carries lower margins, a lower risk profile and lower capital requirements.

Average loan volume increased to \$45.5 billion in 2010 compared to \$44.5 billion in 2009, due to growth in agribusiness and rural energy loans, partially offset by lower average loan volume in our communications portfolio. Average agribusiness volume increased by \$666.4 million primarily as a result of sharp increases in prices for certain agricultural commodities in the latter half of 2010. Growth in our rural energy portfolio primarily resulted from increased lending in the electric distribution sector. Average loans to communications customers declined due to generally weak demand for debt capital in certain sectors of the communications industry.

Average investments decreased to \$11.6 billion in 2010 from \$12.4 billion in 2009. Average investments do not include average cash balances of \$923.1 million and \$2.3 billion in 2010 and 2009, respectively. As debt funding markets have improved, we have held lower levels of cash and investments. During 2010, we and the other System banks implemented an enhanced liquidity framework wherein a higher level of U.S. Treasuries and other U.S. government-guaranteed securities are maintained. This framework helps ensure that our customers have access to a reliable source of credit in all market conditions. Our liquidity position is further discussed in “Liquidity Risk Management” beginning on page 48.

In 2009, our net interest income grew to \$946.0 million, a 10 percent increase from net interest income of \$862.6 million in 2008. Greater 2009 net interest income was primarily the result of greater margins, somewhat offset by lower average loan volume. Our 2009 net interest margin and interest rate spread increased to 1.66 percent and 1.64 percent, respectively, from 1.51 percent and 1.35 percent, respectively, in 2008. Increased margin and spread were primarily a result of the benefit of a steepened yield curve on our asset/liability position in 2009.

Provision for Loan Losses and Reserve for Credit Exposure

The provision for loan losses reflects our expense estimates for losses inherent in our loan and finance lease portfolios, including unfunded commitments. We maintain a reserve for credit exposure for probable and estimable losses based on the factors discussed in “Critical Accounting Estimates – Reserve for Credit Exposure” on page 56. The tables on page 35 summarize the activity in our reserve for credit exposure, by operating segment, for the past five years.

Our provision for loan losses decreased to \$60.0 million in 2010 compared to \$80.0 million for 2009. The 2010 provision relates to our Rural Infrastructure operating segment, reflecting credit challenges related to a limited number of rural energy customers, and, to a lesser degree, our Agribusiness operating segment. The 2009 provision was composed of roughly equal amounts in our Rural Infrastructure and Agribusiness operating segments, and reflected credit stress in certain customer industries, including communications, livestock, ethanol and dairy, as well as the broader impact of the global recession on our customers.

The overall credit quality in our loan portfolio improved in 2010, which was reflected across a number of credit quality indicators. Adverse assets declined to 1.71 percent of total loans and related accrued interest at December 31, 2010 compared to 2.17 percent at December 31, 2009. Loan charge-offs, net of recoveries, were \$57.6 million in 2010 and primarily related to a limited number of rural energy and agribusiness customers. Net charge-offs in 2009 totaled \$65.2 million. Our nonaccrual loans decreased to \$167.0 million (0.33 percent of total loans) at December 31, 2010 from \$307.6 million (0.70 percent of total loans) at December 31, 2009. The decrease in nonaccrual loans primarily relates to charge-offs in the rural energy, agribusiness and communications sectors, the return to accruing status of certain agribusiness customers whose financial performance has improved, and the sale of a limited number of nonaccrual loans in the communications sector.

In 2008, we recorded a \$55.0 million provision for loan losses, largely reflective of challenges facing livestock/poultry customers and overall economic conditions affecting other customer segments in that period. Net charge-offs were \$18.8 million in 2008, and nonaccrual loans at December 31, 2008 were \$217.8 million.

Our total reserve for credit exposure was \$500.5 million at December 31, 2010, compared to \$498.2 million and \$483.4 million as of December 31, 2009 and 2008, respectively. The reserve for credit exposure represented 1.00 percent of total loans as of the end of 2010, compared to 1.13 percent and 1.09 percent of total loans at December 31, 2009 and 2008, respectively. At December 31, 2010, our reserve for credit exposure represented 1.60 percent of non-guaranteed loans when loans to Associations are excluded.

Refer to “Corporate Risk Profile – Credit Risk Management” beginning on page 38 for further information on nonperforming loans, charge-offs, loan quality trends and the factors considered in determining the levels of our provision for loan losses and overall reserve for credit exposure.

Noninterest Income

The following table details our noninterest income for each of the last three years.

| Noninterest Income (\$ in Thousands) | | | |
|---|------------------|------------------|------------------|
| Year Ended December 31, | 2010 | 2009 | 2008 |
| Net Fee Income | \$ 102,620 | \$ 89,947 | \$ 63,734 |
| Prepayment Income | 18,820 | 13,745 | 28,056 |
| Losses on Early | | | |
| Extinguishments of Debt | (26,537) | (18,234) | (33,165) |
| Other-Than-Temporary | | | |
| Impairment Losses, Net | (44,000) | (15,000) | (6,000) |
| Other, Net | 47,656 | 14,503 | 15,786 |
| Total Noninterest Income | \$ 98,559 | \$ 84,961 | \$ 68,411 |

As depicted in the table above, noninterest income is composed primarily of net fee income, loan prepayment fee income and miscellaneous gains and losses, reduced by losses on early extinguishments of debt and impairment losses on investment securities.

Noninterest income increased 16 percent in 2010 to \$98.6 million from \$85.0 million in 2009. The increase included \$33.3 million in refunds from the Farm Credit System Insurance Corporation (Insurance Corporation) related to the Farm Credit Insurance Fund (Insurance Fund). The refunds are included in ‘Other, Net’ within the ‘Noninterest Income’ section of the accompanying consolidated statement of income for the year ended December 31, 2010. As described in Note 5 to the accompanying consolidated financial statements, when the Insurance Fund exceeds the statutory 2 percent secure base amount (SBA), the Insurance Corporation is required to reduce premiums and may refund excess amounts. The Insurance Fund ended 2009 above the SBA. Consequently, in 2010, the Insurance Corporation agreed to distribute to System banks the excess amount generated in 2009, as well as excess amounts previously set aside in 2003.

Net fee income grew to \$102.6 million in 2010 from \$89.9 million in 2009. The improvement in fee income was primarily driven by greater arrangement fees earned on loan transactions in our communications and rural energy portfolios.

Prepayment income increased in 2010 to \$18.8 million as compared to \$13.7 million in 2009 due to a higher level of customer refinancings. We extinguish debt to maintain a desired mix of interest-earning assets and interest-bearing liabilities, and to offset the current and prospective impact of prepayments in our loan and investment portfolios. During 2010, we extinguished \$235.7 million of Systemwide debt compared to \$231.2 million of such extinguishments in 2009. Losses on these early extinguishments of debt were \$26.5 million in 2010 compared to \$18.2 million in 2009. This increase largely resulted from the increase in loan prepayment income described above.

We recorded \$44.0 million in impairment losses on investment securities in 2010 compared to \$15.0 million in 2009. The increase in impairment losses in 2010 was driven by uncertainty regarding the ability of a bond insurer to fulfill its contractual obligations to make payments on certain securities and a greater level of losses on the residential mortgage obligations that back certain of our investment securities. The credit quality of our investment portfolio is discussed in “Liquidity and Capital Resources” beginning on page 51.

Total noninterest income increased by \$16.6 million, or 24 percent, in 2009 from \$68.4 million in 2008. The increase in 2009 noninterest income resulted largely from a \$26.2 million increase in net fee income. The improvement in fee income was primarily driven by fees on unused commitments and increased arrangement and restructuring fees in our agribusiness and rural energy portfolios.

Operating Expenses

The following table details our operating expenses for each of the last three years.

| Analysis of Operating Expenses (\$ in Thousands) | | | |
|--|-------------------|-------------------|-------------------|
| Year Ended December 31, | 2010 | 2009 | 2008 |
| Employee Compensation | \$ 98,971 | \$ 101,868 | \$ 100,998 |
| Insurance Fund Premium | 13,281 | 53,968 | 50,476 |
| Information Services | 16,115 | 16,387 | 17,721 |
| General and Administrative | 42,789 | 17,093 | 15,001 |
| Purchased Services | 20,559 | 7,578 | 8,469 |
| Occupancy and Equipment | 6,479 | 6,806 | 7,054 |
| Travel and Entertainment | 10,922 | 8,895 | 9,544 |
| Farm Credit System Related | 7,094 | 6,636 | 5,918 |
| Total Operating Expenses | \$ 216,210 | \$ 219,231 | \$ 215,181 |
| Total Operating Expenses/ (Net Interest Income + Net Fee Income) | 20.5 % | 21.2 % | 23.2 % |
| Operating Expenses, Net of Insurance Fund Premium/ (Net Interest Income + Net Fee Income) | 19.3 | 16.0 | 17.8 |

Total operating expenses decreased 1 percent in 2010 to \$216.2 million, compared to \$219.2 million for 2009. The decrease included a \$40.7 million decrease in insurance premiums assessed by the Insurance Corporation, partially offset by a \$25.7 million increase in general and administrative expenses and a \$13.0 million increase in purchased services. A discussion of these and other changes in operating expenses follows.

Employee compensation expense, which primarily includes salaries, incentive compensation and employee benefits, decreased slightly to \$99.0 million in 2010, or by 3 percent, largely due to lower levels of incentive compensation expense recorded in 2010. As of December 31, 2010, we employed 719 associates, compared to 698 and 695 at December 31, 2009 and 2008, respectively.

The decrease in Insurance Fund premium expenses in 2010 resulted from a reduction in the premium assessment. In the second quarter of 2010, the Insurance Corporation reduced full-year 2010 premiums to five basis points of average outstanding adjusted insured debt obligations from the 10 basis points it had initially set for 2010. Premium rates were 20 basis points for all of 2009. The Insurance Corporation raised the premium rate to six basis points for 2011, subject to review at mid-year.

General and administrative expenses increased to \$42.8 million in 2010 from \$17.1 million in 2009, primarily due to costs related to the settlement of a business dispute in our Rural Infrastructure operating segment in the first quarter of 2010. As noted in "Senior Officers Compensation Discussion and Analysis" on page 124, the settlement of this dispute in early 2010 impacted the level of incentive compensation payouts related to 2009.

Purchased services expense increased to \$20.6 million in 2010 from \$7.6 million in 2009. The increase relates to expenses incurred in the evaluation of a potential merger with U.S. AgBank, which is discussed in "Recent Developments" on page 57, and legal fees relating to the business dispute settlement. Increased purchased services expense also resulted from costs associated with efforts to more closely align our loan processing practices with our enterprise-wide risk management objectives.

Information services expenses were \$16.1 million in 2010, relatively consistent with the \$16.4 million in 2009. Occupancy and equipment expenses were \$6.5 million and \$6.8 million in 2010 and 2009, respectively. Our travel and entertainment expenses increased to \$10.9 million in 2010 from \$8.9 million in 2009, due primarily to a greater level of expenditures on customer meetings and other customer-facing activities.

Farm Credit System related expenses of \$7.1 million in 2010 increased from \$6.6 million in 2009 and substantially represent our share of costs to fund the operations of the FCA, our regulator. Each System institution is assessed a pro rata share of the FCA's total expenses based primarily on each institution's average risk-adjusted assets.

Total operating expenses as a percent of net interest income plus net fee income were 20.5 percent in 2010 compared to 21.2 percent in 2009 and 23.2 percent in 2008. Excluding the impact of Insurance Fund premium expenses, operating expenses as a percent of net interest income plus net fee income were 19.3 percent in 2010, compared to 16.0 percent in 2009 and 17.8 percent in 2008. The 2010 percentages reflect the increases in general and administrative and purchased services expenses, as previously described.

The increase in total operating expenses from 2008 to 2009 resulted principally from a \$3.5 million increase in Insurance Fund premiums and a \$2.1 million increase in general and administrative expenses. The increase in Insurance Fund premiums resulted from a mid-2008 change in the base upon which premiums are assessed as well as increases in the premium rates. Effective July 1, 2008, the premium base changed to average adjusted insured debt obligations, which is a larger base than outstanding loan volume. General and administrative expenses increased due to higher levels of support provided to organizations that advance the mission of the System and the industries we serve.

Provision for Income Taxes

Our provision for income taxes decreased to \$159.4 million in 2010 from \$166.3 million in 2009 and our effective tax rate decreased to 20.6 percent for 2010 as compared to 22.7 percent for 2009. The decrease in both the amount and the effective rate of income tax expense primarily resulted from increased earnings in the tax-exempt portion of CoBank's business activities. Our effective tax rates are significantly less than the applicable federal and state statutory income tax rates primarily due to tax-deductible patronage distributions.

Our effective tax rate increased to 22.7 percent for 2009 as compared to 19.3 percent for 2008. The increase resulted from a decrease in the level of patronage distributions for 2009 as compared to 2008 due to lower patronage-based agribusiness loan volume.

Operating Segment Financial Review

We conduct lending operations through three operating segments: Agribusiness, Strategic Relationships and Rural Infrastructure.

We hold investments and other highly-liquid funds primarily to provide the liquidity necessary to support our core lending operations. Accordingly, net interest income on investment securities, federal funds sold, securities purchased under resale agreements and other highly-liquid funds is allocated to all operating segments, whereas the underlying investment assets are not allocated.

In addition to the operating segments described below, our Banking Services Group (BSG) provides capital markets solutions, non-credit products and services, and information

and knowledge sharing services. As part of its capital markets solutions, which support our lending divisions, BSG manages syndications and loan sales with approximately 124 financial institutions. In 2010, we syndicated or sold approximately \$13.7 billion of loan commitments to System entities and other financial institutions to help meet customers' credit needs and to effectively manage our capital and risk diversification.

BSG's non-credit products and services include cash management, commercial credit card and merchant card processing solutions. Revenues generated from non-credit products and services, as well as BSG's operating expenses, are allocated to the appropriate operating segments. BSG's information and knowledge sharing services provide the Bank and its customers marketplace insight to enhance understanding of emerging business opportunities and risks.

Net income by operating segment is summarized in the accompanying table and is more fully disclosed in Note 14 to the accompanying consolidated financial statements. The following tables also provide period-end and average loan amounts.

| Net Income by Operating Segment (\$ in Thousands) | | | |
|---|-------------------|-------------------|-------------------|
| Year Ended December 31, | 2010 | 2009 | 2008 |
| Operating Segment: | | | |
| Agribusiness | \$ 365,247 | \$ 288,533 | \$ 306,479 |
| Strategic Relationships | 80,446 | 96,964 | 67,846 |
| Rural Infrastructure | 175,596 | 184,477 | 165,610 |
| Total Operating Segments | 621,289 | 569,974 | 539,935 |
| Corporate/Other | (7,522) | (4,558) | (6,502) |
| Total | \$ 613,767 | \$ 565,416 | \$ 533,433 |

Period-end Loan Portfolio by Operating Segment (\$ in Millions)

| December 31, | 2010 | 2009 | 2008 | 2007 | 2006 |
|-------------------------|------------------|------------------|------------------|------------------|------------------|
| Agribusiness | \$ 22,676 | \$ 17,469 | \$ 18,498 | \$ 19,582 | \$ 15,449 |
| Strategic Relationships | 15,392 | 15,271 | 15,026 | 12,211 | 9,967 |
| Rural Infrastructure | 11,924 | 11,434 | 11,026 | 8,698 | 7,660 |
| Total Loans | \$ 49,992 | \$ 44,174 | \$ 44,550 | \$ 40,491 | \$ 33,076 |

Average Loan Portfolio by Operating Segment (\$ in Millions)

| Year Ended December 31, | 2010 | 2009 | 2008 | 2007 | 2006 |
|----------------------------|------------------|------------------|------------------|------------------|------------------|
| Agribusiness | \$ 18,896 | \$ 18,229 | \$ 21,843 | \$ 16,866 | \$ 12,958 |
| Strategic Relationships | 15,118 | 15,062 | 13,670 | 10,602 | 8,593 |
| Rural Infrastructure | 11,524 | 11,236 | 9,861 | 7,941 | 7,272 |
| Total Average Loans | \$ 45,538 | \$ 44,527 | \$ 45,374 | \$ 35,409 | \$ 28,823 |

The following table presents activity in the reserve for credit exposure by operating segment.

| Analysis of the Reserve for Credit Exposure (\$ in Thousands) | | | | | |
|--|-------------------|-------------------|-------------------|-------------------|-------------------|
| | 2010 | 2009 | 2008 | 2007 | 2006 |
| Beginning of Year | \$ 498,190 | \$ 483,421 | \$ 447,226 | \$ 438,231 | \$ 437,140 |
| Charge-offs: | | | | | |
| Agribusiness | (25,893) | (36,958) | (17,574) | (1,859) | (23,302) |
| Strategic Relationships | - | - | - | - | - |
| Rural Infrastructure | (50,502) | (33,240) | (8,000) | - | - |
| Total Charge-offs | (76,395) | (70,198) | (25,574) | (1,859) | (23,302) |
| Recoveries: | | | | | |
| Agribusiness | 4,234 | 4,850 | 3,916 | 7,508 | 7,601 |
| Strategic Relationships | - | - | - | - | - |
| Rural Infrastructure | 14,514 | 117 | 2,853 | 8,346 | 12,792 |
| Total Recoveries | 18,748 | 4,967 | 6,769 | 15,854 | 20,393 |
| Net (Charge-offs) Recoveries | (57,647) | (65,231) | (18,805) | 13,995 | (2,909) |
| Provision (Reversal) Charged (Credited) to Earnings | 60,000 | 80,000 | 55,000 | (5,000) | 4,000 |
| End of Year | \$ 500,543 | \$ 498,190 | \$ 483,421 | \$ 447,226 | \$ 438,231 |
| Components: | | | | | |
| Allowance for Loan Losses | \$ 400,744 | \$ 369,817 | \$ 329,198 | \$ 447,226 | \$ 438,231 |
| Reserve for Unfunded Commitments | 99,799 | 128,373 | 154,223 | n/a | n/a |
| Total Reserve for Credit Exposure (RCE) | \$ 500,543 | \$ 498,190 | \$ 483,421 | \$ 447,226 | \$ 438,231 |
| RCE/Total Loans | 1.00 % | 1.13 % | 1.09 % | 1.10 % | 1.32 % |
| RCE/Non-guaranteed Loans (Excluding Loans to Associations) | 1.60 | 1.98 | 1.85 | 1.66 | 2.03 |
| RCE/Impaired Loans | 299 | 154 | 218 | 2,677 | 504 |
| RCE/Nonaccrual Loans | 300 | 162 | 222 | 3,020 | 531 |
| Net (Charge-offs) Recoveries /Average Loans | (0.13) | (0.15) | (0.04) | 0.04 | (0.01) |

| Analysis of the Reserve for Credit Exposure (\$ in Thousands) | | | | | |
|--|-------------------|-------------------|-------------------|-------------------|-------------------|
| December 31, | 2010 | 2009 | 2008 | 2007 | 2006 |
| Agribusiness | \$ 352,816 | \$ 367,308 | \$ 360,416 | \$ 304,074 | \$ 281,427 |
| Strategic Relationships | - | - | - | - | - |
| Rural Infrastructure | 147,727 | 130,882 | 123,005 | 143,152 | 156,804 |
| Total Reserve for Credit Exposure | \$ 500,543 | \$ 498,190 | \$ 483,421 | \$ 447,226 | \$ 438,231 |

Agribusiness

Overview

Agribusiness provides financial services to cooperatives and other businesses engaged in agricultural activities such as grain handling and marketing, farm supply, food processing, dairy, livestock, fruits, nuts, vegetables, cotton, biofuels and forest products. Primary products and services include traditional loan programs, lines of credit, leasing, trade finance, tax-exempt bond issuances, capital markets solutions, and cash management and investment products. To enhance portfolio diversification, and to assist System partners in meeting the needs of their customers, we purchase participations in agribusiness loans from other System entities and financial institutions. Our Agribusiness segment includes our International Division, which provides short-term and medium-term trade finance to support the export of U.S. agricultural products, as well as Farm Credit Leasing, which provides lease-related financial services to Association partners, agribusinesses, agricultural producers and rural utilities.

A significant level of Agribusiness loan volume relates to the seasonal financing of grain inventories, which is affected by a number of factors, including commodity prices, selling patterns, transportation availability, grain volume and the relationship between cash and futures prices in the grain commodities markets. Agribusiness loan volume generally reaches a seasonal low in late summer or early fall before harvest financing demands result in loan volume increases beginning in the late fall of each year. Peak loan volume typically occurs in late winter or early spring. Significant changes in the price of grain and other agricultural commodities can have an immediate and significant impact on this segment's loan volume.

Our Agribusiness customers face evolving globalization of markets, changing market demands and increasing regulation. These trends are leading some of our cooperative customers to consolidate and merge, enter into joint ventures or form alliances while developing new markets and innovative, value-added products. In some cases, these initiatives have resulted in larger individual credit commitments. We have been able to continue to meet our customers' needs through our strategic partnerships with System entities and commercial banks.

The International Division's borrowers consist primarily of commercial banks in foreign countries (generally emerging markets), exporters who sell and ship U.S. agricultural products to international markets and, in limited cases, the foreign importers themselves. The primary focus of the International Division is to finance the export of U.S. agricultural products with particular focus on supporting the U.S. government-sponsored export loan guarantee General Sales Manager (GSM) program. Loan volume in the

International Division is largely dependent on the continued existence and availability of the GSM program, where a significant portion of borrowings are guaranteed by the U.S. government. As of December 31, 2010, we had \$4.0 billion in international loans, 87 percent of which were guaranteed by the U.S. government. The International Division maintains a representative office in Singapore.

2010 Performance

Our Agribusiness segment generated \$365.2 million in net income for 2010, a 27 percent increase from the \$288.5 million in net income for 2009. This increase was largely driven by a lower provision for loan losses, increased net interest income, and a decrease in operating expenses.

Net interest income improved by \$28.7 million due to higher loan volume and increased lending spreads. These factors more than offset the previously-noted decreased benefit of our asset/liability position in 2010. Average Agribusiness loan volume increased to \$18.9 billion in 2010 from \$18.2 billion in 2009. The increase in average loan volume resulted from a sharp rise in prices for certain agricultural commodities in the latter half of 2010, which drove increased borrowing by agribusiness customers. Generally, higher prices for agricultural commodities lead to increased financing requirements for many of our customers who borrow to finance inventory purchases and receivables. The following table depicts certain commodity price trends since 2007. Prices represent the yearly high and low "nearby" futures price per bushel for corn, soybeans and wheat. Nearby futures contracts represent those contracts with the nearest settlement date.

| Year Ended | | | | |
|------------------|---------|---------|---------|---------|
| December 31, | 2010 | 2009 | 2008 | 2007 |
| Commodity | | | | |
| Corn: | | | | |
| High | \$ 6.30 | \$ 4.50 | \$ 7.61 | \$ 4.56 |
| Low | 3.25 | 3.06 | 3.09 | 2.34 |
| Soybeans: | | | | |
| High | 13.84 | 12.67 | 16.49 | 12.21 |
| Low | 9.00 | 6.28 | 7.76 | 6.64 |
| Wheat: | | | | |
| High | 8.08 | 6.74 | 12.53 | 9.80 |
| Low | 4.26 | 4.40 | 4.76 | 4.38 |

Agribusiness recorded a \$7.2 million provision for loan losses in 2010 compared to \$39.0 million for 2009. The decrease reflects an improvement in Agribusiness loan quality, as reflected by a lower level of adverse loans. In addition, net charge-offs decreased to \$21.7 million in 2010 compared to \$32.1 million for 2009. Nonaccrual loans decreased to \$93.4 million at December 31, 2010 compared to \$209.1 million at December 31, 2009 due to the return to accruing status of certain customers whose financial performance has improved as well as the aforementioned charge-offs.

Noninterest income in our Agribusiness segment decreased modestly in 2010 as compared to 2009, as the impact of impairment losses on investment securities and other items more than offset the benefit of refunds of a portion of Insurance Fund premiums paid in prior years. Agribusiness operating expenses decreased by \$17.5 million in 2010 primarily due to the lower Insurance Fund premium rate in effect for 2010.

Strategic Relationships

Overview

Strategic Relationships includes the direct funding relationships with our affiliated Association customer-owners: Northwest Farm Credit Services, Farm Credit East, Yankee Farm Credit and Farm Credit of Maine, as well as funding relationships with other System institutions.

At December 31, 2010, our Strategic Relationships portfolio included \$11.3 billion of direct loans to our affiliated Associations and \$4.0 billion of purchased participations in loans made by three other System banks to certain of their affiliated Associations, most notably, the Farm Credit Bank of Texas (\$3.4 billion). See Note 17 to the accompanying consolidated financial statements for further discussion of our affiliated Associations. In addition, the supplemental schedules that follow the accompanying consolidated financial statements contain unaudited combined financial information of our affiliated Associations.

We are focused on developing and maintaining strong relationships with System Associations and banks. Partnerships with Associations allow us to provide credit and non-credit services to a more diverse set of customers. The Associations' strong market presence and local relationship management, combined with our product suite and lending capacity, provide a competitive advantage in attracting and retaining customers in the rural and agricultural sectors.

2010 Performance

Average Strategic Relationships loan volume was \$15.1 billion during both 2010 and 2009, reflecting overall weak loan demand at the producer level of the U.S. farm economy. Strategic Relationships' net income decreased 17 percent to \$80.4 million for 2010 from \$97.0 million for 2009. The decrease in earnings was primarily the result of a \$20.5 million decline in net interest income due to the previously noted decreased benefit of our asset/liability position during 2010. Strategic Relationships 2010 operating results did not benefit from the refunds of a portion of Insurance Fund premiums paid in prior years because these amounts were passed on directly to our Association customers. Strategic Relationships has no income tax expense as the earnings on its business activities are tax exempt pursuant to CoBank's charter.

As discussed on page 41, the credit quality classification of a loan to a nonaffiliated Association was downgraded in 2010 to the 'Substandard' category, while another loan to a nonaffiliated Association was downgraded to the 'Special Mention' category. As a wholesale lender to Association customers, we benefit from the diversification of the Association loan portfolios and our strong collateral position. In addition, the earnings, capital and loan loss reserves of the Associations provide us a buffer from losses in their respective loan portfolios. As a result, the overall loan quality in our Strategic Relationships portfolio remains good. Lower margins in the Strategic Relationships operating segment are commensurate with the lower risk profile and lower regulatory capital requirements.

Rural Infrastructure

Overview

Rural Infrastructure provides financial services to companies in the energy, communications and water industries. Customers in this segment include rural electric generation and transmission cooperatives, electric distribution cooperatives, independent power producers, rural local exchange carriers, wireless providers, data transport networks, cable television systems, and water and waste water companies. Primary products and services include traditional loan programs, lines of credit, leasing, project financing, tax-exempt bond issuances, capital markets solutions and cash management and investment products.

Weak economic conditions and regulatory uncertainty have slowed capital project spending in certain power supply sectors. Notwithstanding these factors, customers in the midst of plant enhancements aimed at meeting long-term planning requirements or complying with environmental regulations continue to demand construction financing. Growth in renewable energy projects, including wind and hydro, continues at a moderate pace and represents additional construction and term financing opportunities. Loans to a significant portion of our electric cooperative customers carry a lower regulatory capital requirement than loans to customers in other sectors, which is reflective of a lower credit risk profile.

In the communications industry, we offer financial services to rural communications companies that are positioned to provide a range of services, including voice (both wire-line and wireless), broadband and video. While loan volume in our communications portfolio declined in 2010 due to weak demand for debt capital in certain sectors, we anticipate opportunities in merger and acquisition activity, which has increased recently due to improved capital markets conditions and a gradual improvement in the economy. We expect consolidation to continue as carriers seek to improve operating efficiencies and gain market share in their highly competitive industry. Capital spending will also likely continue as wire-line carriers enhance their networks with fiber optics and wireless carriers upgrade to fourth generation (4G) data technology.

Significant, ongoing capital requirements for the water industry are being driven by projects that improve water supply and quality, and by tighter environmental regulation. Over the long term we anticipate additional growth in this sector as private capital displaces declining government funding. We expect further penetration of our traditional water markets and an increase in business with mid-sized, mutually-owned water systems.

2010 Performance

Rural Infrastructure net income decreased 5 percent to \$175.6 million for 2010 from \$184.5 million for 2009. The decrease in earnings primarily resulted from a higher provision for loan losses and increased operating expenses, partially offset by increased noninterest income.

Net interest income declined slightly to \$315.6 million for 2010 as compared to \$317.1 million in the prior year primarily as a result of the decreased benefit of our asset/liability position. Average loan volume grew to \$11.5 billion in 2010 from \$11.2 billion in 2009. Growth in Rural Infrastructure average loan volume primarily resulted from increased lending activity in the electric distribution sector driven by refinancing of borrowings from other lenders and financing of capital expenditures. This growth was partially offset by a decline in loans to our communications customers, reflecting weak demand for debt capital in certain sectors of the communications industry.

Rural Infrastructure recorded a \$52.8 million provision for loan losses in 2010, as compared to a \$41.0 million provision in the prior year. The increase in the provision for loan losses resulted from credit challenges related to a limited number of rural energy customers. Notwithstanding these specific customer challenges, the overall loan quality of our rural energy portfolio remains strong. Nonaccrual loans decreased to \$73.6 million at December 31, 2010 from \$98.5 million at December 31, 2009, primarily due to the sale of certain nonaccrual loans in the communications sector and charge-offs in the rural energy and communications sectors. Rural Infrastructure recorded net charge-offs of \$36.0 million and \$33.1 million for 2010, and 2009, respectively. Charge-offs in 2010 were related to a limited number of rural energy and communications customers, somewhat offset by a recovery of a previously charged-off communications loan. The charge-offs in 2009 related to certain communications customers.

Rural Infrastructure operating expenses increased by \$16.1 million in 2010. The increase in operating expenses primarily resulted from the settlement of a business dispute in early 2010, which was partially offset by the benefit of the lower Insurance Fund premium rate in effect in 2010. Noninterest income improved by \$16.8 million as a result of the refunds of a portion of Insurance Fund premiums paid in prior years and increased arrangement fees earned on transactions in our communications and rural energy portfolios, which more than offset the impact of impairment losses on investment securities.

Corporate Risk Profile

Managing enterprise risk is an essential part of successfully operating our Bank. Our primary risk exposures are credit, interest rate, liquidity, operational and reputation. Credit risk is the risk of not collecting the amounts due on loans, investments or derivatives. Interest rate risk is the potential reduction of net interest income and the market value of equity as a result of changes in interest rates. Liquidity risk is the potential inability to repay obligations or fund borrowers on a timely basis. Operational risk is the risk of loss resulting from inadequate or failed processes or systems, breaches of internal controls or compliance requirements, the risk of fraud, and other operational matters. Reputation risk is the risk of loss arising from negative public opinion.

Our Risk Management Group oversees the Bank's enterprise-wide risk management through measurement and control processes addressing all of the Bank's primary risk exposures, including credit, interest rate, liquidity, operational and reputation risks. The following is a discussion of these risks, and our approach to managing them.

Credit Risk Management

Credit risk exists in our lending, investing and derivatives activities. Credit risk in lending arises from changes in a borrower's ability to repay funds borrowed, changes in collateral values, and changes in industry and economic conditions. Credit risk in our investment portfolio primarily results from changes in residential real estate values, default rates on collateral underlying mortgage-backed and asset-backed securities, and the credit worthiness of bond insurers who insure certain of our investment securities. Credit risk in our derivatives portfolio results from changes in a derivative counterparty's ability to perform under the terms of the contract.

We actively manage credit risk through a well-defined, Board-approved portfolio strategy, a structured and centralized credit approval process, a well-disciplined risk management process, and a sound credit administration program. We have established comprehensive credit guidelines and procedures that ensure consistency and integrity of information related to the credit risk in our loan, investment and derivatives portfolios.

Various groups and committees within CoBank, including our Board of Directors, have a role in managing credit risk, as described below.

CoBank Board of Directors:

- Establishes overall lending, investment and reserve policies;
- Approves portfolio strategy; and
- Monitors loan volume, loan quality trends, significant high-concern or troubled loans, and the credit quality of our investment and derivatives portfolios.

CoBank Loan Committee (CLC), which is appointed by the President and CEO, and includes the Chief Credit Officer and senior management of the Credit Group and the lending groups:

- Holds ultimate credit authority as authorized by Board policy;
- Delegates lending authorities to specific committees based on size of exposure and risk rating;
- Approves limits for investment obligors and derivative counterparties;
- Acts on individual credit actions or administrative matters; and
- Approves exceptions to exposure limits if conditions warrant.

Credit Group, which reports to the President and CEO:

- Manages the credit approval process within concentration limits established for the loan portfolio, pursuant to Board policies;
- Reviews assigned risk ratings for accuracy and conformity with our established guidelines;
- Recommends limits with respect to investment obligors and derivative counterparties; and
- Manages significant high-risk or troubled loans.

Risk Management Group, which reports to the President and CEO with certain individuals having dotted line responsibility to the Audit Committee and the Board of Directors:

- Oversees development of portfolio strategies, the analysis of the reserve for credit exposure, and economic capital;
- Provides independent reporting to the Board of Directors on the quality of the Bank's assets; and
- Provides independent reporting to the Board of Directors on the system of internal controls and material findings of the Asset Review and Internal Audit Divisions.

Asset and Liability Committee (ALCO), which includes the President and CEO, Chief Banking Officer, Chief Operating Officer, Chief Financial Officer, and Chief Risk Officer:

- Oversees credit risk within the investment portfolio; and
- Reviews counterparty credit risk arising from derivative transactions.

Credit Risk Related to Loans

The key elements of our credit risk management related to lending include our portfolio strategy, the credit approval process, and the use of exposure and concentration limits, which are explained below.

Portfolio Strategy

As part of the annual business and financial planning process, the Board of Directors reviews and approves the Bank's portfolio strategy. Management regularly analyzes performance with respect to the portfolio strategy and reports the results to the Board of Directors. The objectives of our portfolio strategy are to safely fulfill our lending mission to our customers, ensure appropriate portfolio diversification, and optimize returns based on risk and profitability, all within established capital parameters.

Credit Approval

The most critical element in managing and controlling risk in the extension of credit is the initial decision to make a loan and the resulting structure and terms of the relationship with the borrower.

We place significant emphasis on the evaluation and understanding of a borrower's management and business, the initial credit analysis and the approval process. We emphasize cash flow and repayment capacity as primary sources for collection of loans, while collateral is normally considered a secondary source of repayment. In circumstances where the credit decision places substantial reliance on collateral to repay the loans, independent appraisals may be used to assist in the collateral valuation. Such appraisals are conducted in accordance with FCA regulations and professional appraisal standards.

As discussed on page 37, we have a strong collateral position with respect to our loans to Associations. In addition, the earnings, capital and loan loss reserves of the Associations provide us a buffer from losses in their respective loan portfolios. Loans to our affiliated Associations are governed by a General Financing Agreement, as described in Note 17 to the accompanying consolidated financial statements.

With the exception of certain small-dollar lease transactions, no single individual is granted credit approval authority within CoBank. All approvals or credit actions require formal documentation. Each borrower is assigned a risk rating based on two measurements: probability of default (PD) and loss given default (LGD). The PD rating system uses a 14-point scale of 1 (highest quality) to 14 (lowest quality). The PD rating is primarily determined by the financial characteristics of the borrower and reflects the probability of default driven by several factors, including business risk, industry risk, management capability and financial condition. The LGD rating is intended to approximate the degree of potential loss in the event the borrower defaults.

Exposure and Concentration Limits

We make extensive use of exposure limits to manage risk and volatility in the loan portfolio. Exposure to individual borrowers and related entities is managed through a risk matrix that considers the dollar exposure, type of exposure and risk rating of the borrower. Individual borrower exposures are examined at the time of each borrower's formal review, which occurs at least annually. The dollar exposure, risk rating and type of credit extended further determine the delegated level of authority required to approve the credit. These individual borrower exposures are then further subject to total portfolio limits on exposure to different industries and countries. Exposure limits for different industries are reviewed quarterly while exposure limits for different countries are reviewed annually. We allow for more frequent evaluation when necessary. Exceptions to these exposure limits may be granted by the CLC if conditions warrant.

We also manage lending credit exposures and concentrations by selling and purchasing loans. Our capabilities in selling and purchasing loans will continue to be critical to managing the portfolio and maintaining market discipline.

While we believe these standards, processes and tools are appropriate to manage our credit risk, there is no assurance that significant deterioration in loan quality will not occur, which could reduce our future earnings.

We are limited to making loans and providing related financial services to eligible borrowers in certain specified industry sectors, as mandated by the Farm Credit Act. As a result, we have a concentration of loans to the agricultural and rural infrastructure industries. The significant risk factors affecting credit conditions in these industries within each of our operating segments are described below.

Agribusiness

The relationship of demand for and supply of U.S. agricultural products in a global marketplace can significantly impact the volume, earnings and loan quality of our Agribusiness portfolio. In addition, changes in credit markets can affect our ability to buy and sell loans in this portfolio.

The levels and price volatility of agricultural commodities can impact the profitability and loan quality of a significant portion of our Agribusiness customers. Changes to the levels and prices of agricultural commodities result from, among other factors, seasonal weather conditions; changes in the production levels of ethanol, which are impacted by legislative initiatives, the price of oil and other factors; financial investment in the commodity futures markets by non-agricultural interests; and changing export markets. Market prices for food products also have a significant affect on a number of customer sectors within our Agribusiness portfolio.

Major international events, including military conflicts, terrorism, political disruptions or trade agreements can affect, among other things, the price of commodities or products used or sold by our borrowers or their access to markets. In addition, biological or disease risk in human or livestock populations can impact the supply of and demand for agricultural products.

The U.S. agricultural sector receives financial support from the U.S. government through payments authorized under federal legislation. While U.S. government support for agriculture has been consistent, there is no assurance that such financial support will remain at current levels. Although most of our customers do not generally receive direct payments from federal support programs, a significant reduction or elimination of such support would have a negative impact on the loan quality of certain borrowers who derive a significant share of their earnings from farmers affected by such a reduction. Other political, legislative and regulatory activities may also impact the level or existence of certain government programs.

Strategic Relationships

Approximately \$15.4 billion of our total loan portfolio at December 31, 2010 represented direct loans to our affiliated Associations and participations in the direct loans of non-affiliated Associations. The risk factors previously discussed in the "Agribusiness" section can also affect loan quality at Associations; however, the impact of such factors on farmers and other producers served by Associations may not be the same as the impact on cooperatives and other customers served by our Agribusiness operating segment. As noted previously, the loan quality of our Strategic Relationships portfolio is enhanced by our strong collateral position and the earnings, capital and loan loss reserves of the Associations, which provide us a buffer from losses in their respective loan portfolios.

Rural Infrastructure

We fund the construction, operations and maintenance activities of rural energy, communications and water companies. A general slowdown in the U.S. economy can reduce industrial and residential demand for services and negatively affect customers in our Rural Infrastructure portfolio. Changes in credit markets can also impact our ability to buy and sell loans in this portfolio.

Fluctuating weather conditions can adversely affect our customers in the energy industry. The pace and degree of the restructuring of the electric energy industry in the United States, including the need for additional generating capacity and the lack of open access transmission, may also impact the future loan quality of our energy loans. Further, constraints on carbon emissions and other environmental standards could adversely impact customers in our energy portfolio.

The communications industry is affected by significant competition. Regulatory, legislative and technological changes may impact the future competitive position and markets for the communications industry. These factors may place downward pressure on the loan quality of certain sectors of the communications industry. In addition, decreased cash flows in today's economic environment, the inability to successfully integrate merged or acquired companies, or the lack of availability of debt and equity capital could adversely affect certain customers in our communications portfolio.

Credit Quality Conditions and Measurements in Our Loan Portfolio

The following table presents loans and related accrued interest receivable classified pursuant to our regulator's Uniform Loan Classification System, as a percent of total loans and related accrued interest.

| Loan Quality Ratios | | | | |
|---------------------|-----------------|-----------------|-----------------|--|
| December 31, | 2010 | 2009 | 2008 | |
| Acceptable | 94.76 % | 95.83 % | 97.20 % | |
| Special Mention | 3.53 | 2.00 | 1.24 | |
| Substandard | 1.62 | 2.02 | 1.50 | |
| Doubtful | 0.09 | 0.15 | 0.06 | |
| Loss | - | - | - | |
| Total | 100.00 % | 100.00 % | 100.00 % | |

Notwithstanding the increase in the level of "Special Mention" loans, which is discussed below, the overall credit quality in our loan portfolio improved in 2010, which was reflected across a number of credit quality indicators. Adversely classified loans (substandard and doubtful), pursuant to the FCA's Uniform Loan Classification System, decreased from 2.17 percent of total loans and related accrued interest at December 31, 2009 to 1.71 percent at December 31, 2010. The level of 'Special Mention' loans increased from 2.00 percent of total loans and related accrued interest at December 31, 2009 to 3.53 percent at December 31, 2010. In 2010, a \$150.0 million loan to a nonaffiliated Association was downgraded to 'Substandard' while another \$400.0 million loan to a nonaffiliated Association was downgraded to 'Special Mention.' As noted previously, we have a strong collateral position in the assets of Association borrowers, and the earnings, capital and loan loss reserves of the Associations serve as an additional layer of protection against losses. As a result, while the downgrades reflect credit deterioration in the underlying retail loans held by these Associations, they are not indicative of an increased risk of loss related to our wholesale Association loans. No provision for loan losses or reserve for credit exposure has been recorded at the Bank related to any Association loan.

Summary of High-Risk Assets (\$ in Millions)

| December 31, | 2010 | 2009 | 2008 | 2007 | 2006 |
|---|---------------|---------------|---------------|--------------|--------------|
| Nonaccrual Loans | \$ 167 | \$ 308 | \$ 218 | \$ 15 | \$ 83 |
| Accruing Loans 90 Days or More Past Due | 1 | 15 | 4 | 2 | 3 |
| Restructured Loans | - | - | - | - | 1 |
| Total Impaired Loans | 168 | 323 | 222 | 17 | 87 |
| Other Property Owned | 7 | - | - | - | 3 |
| Total High-Risk Assets | \$ 175 | \$ 323 | \$ 222 | \$ 17 | \$ 90 |

Total nonaccrual loans were \$167.0 million at December 31, 2010 compared to \$307.6 million and \$217.8 million at December 31, 2009 and 2008, respectively. The decrease from 2009 to 2010 was primarily due to charge-offs in the agribusiness, rural energy and communications sectors, the return to accruing status of certain agribusiness customers whose financial performance has improved, and the sale of a limited number of nonaccrual loans in the communications sector, as noted previously. The year-over-year increase in nonaccruals from 2008 to 2009 was primarily due to credit challenges affecting a limited number of our customers in the communications, livestock, ethanol and dairy industries. Nonaccrual loans as a percent of our total loan portfolio improved to 0.33 percent as of December 31, 2010 compared to 0.70 percent at December 31, 2009. Over the past 10 years, nonaccrual loans have averaged 0.63 percent of the total loan portfolio.

Net loan charge-offs totaled \$57.6 million in 2010 and \$65.2 million in 2009. Gross charge-offs in 2010 were \$76.4 million compared to \$70.2 million in 2009. Gross charge-offs in 2010 were primarily associated with a limited number of rural energy, agribusiness and communications customers.

Our reserve for credit exposure totaled \$500.5 million and represented 1.00 percent of outstanding loans as of the end of 2010, compared to 1.13 percent and 1.09 percent of total loans at December 31, 2009 and 2008, respectively. At December 31, 2010, our reserve for credit exposure represented 1.60 percent of non-guaranteed loans when loans to Associations are excluded. As part of our overall assessment of risk in the loan portfolio and the reserve for credit exposure as of December 31, 2010, we have considered the following factors:

- Credit stress in our loan portfolio would be increased by lingering weakness in the general economy;
- Changes in grain markets and related price volatility may impact the liquidity, leverage and earnings of our farm supply, grain and marketing customer base;
- Certain customer sectors within our communications portfolio continue to experience stress resulting from land line losses and failure to achieve targeted growth objectives from enhanced product lines;
- A decline in the value of collateral supporting certain of our loans given uncertainty in the economy and industry outlook;
- Dairy and livestock industries remain susceptible to margin pressure and operating losses; and
- Weakness in the housing market continues to adversely impact the forest products industry.

While overall loan quality improved in 2010, we could see a decline in credit quality in certain areas of our loan portfolio as a result of ongoing challenges in many parts of the global economy.

See “Critical Accounting Estimates – Reserve for Credit Exposure” on page 56 for a more complete description of our process to determine the adequacy of our reserve for credit exposure.

Credit Risk Related to Investments and Derivatives

We minimize credit risk in our liquidity investment portfolio by investing only in securities that, at purchase, are rated triple-A by one or more major rating agencies. In addition, we invest primarily in securities issued or guaranteed by the U.S. government or one of its agencies. At year-end 2010, approximately 96 percent of our investment portfolio is composed of securities with either an implied or explicit guarantee of the U.S. government. More specifically, 43 percent of our investment portfolio securities carry a full faith and credit guarantee of the U.S. government. Such securities include mortgage-backed securities issued by the Government National Mortgage Association and U.S. Treasury and other debt securities, including loans backed by the Small Business Administration. Approximately 53 percent of our investment portfolio consists of securities issued by government agencies, primarily mortgage-backed securities issued by the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). Such investments carry the implied backing of the U.S. government and government actions since mid-2008

to strengthen the capital of, and improve the liquidity of securities issued by, Fannie Mae and Freddie Mac indicate a strong level of support by the U.S. government regarding the obligations of these housing GSEs. To a much lesser extent, and largely prior to 2006, we also invested in non-agency mortgage- and asset-backed securities. Such securities comprised approximately 4 percent of our investment portfolio at December 31, 2010. This portion of our portfolio continues to pay down and we did not purchase any non-agency mortgage- and asset-backed securities in 2008, 2009 or 2010.

Prior to purchase, we assess the credit quality of the underlying pools of mortgages, which is typically enhanced through our senior position in receiving cash flows, overcollateralization, excess spreads or through insurance provided by third-party bond insurance companies. Deterioration in the financial condition of certain bond insurance companies, coupled with current issues in the residential mortgage market, led to the impairment of certain of our investment securities during each of the past three years. The credit quality of our investment portfolio as of December 31, 2010 and impairment losses on investment securities are more fully discussed in “Liquidity and Capital Resources” beginning on page 51.

Our counterparty credit risk arising from derivative transactions is managed within credit methodologies and limits approved by the CLC. Managing counterparty exposure is more fully discussed in “Counterparty Exposure” beginning on page 47.

Interest Rate Risk Management

We are subject to interest rate risk, which is defined as the risk of changes to future earnings and long-term market value of equity due to changes in interest rates. This risk primarily arises from our equity positioning and differences in the timing between the contractual maturities, repricing characteristics, and prepayments of our assets and the financing obtained to fund these assets. This risk can also arise from embedded caps in certain of our investments and differences between the interest rate indices used to price and fund our assets. Our asset/liability management objective is to manage the mix of interest-earning assets and interest-bearing liabilities to reduce interest rate risk and stabilize our net interest income while enhancing profitability and insulating shareholders’ equity from significant adverse fluctuations in market interest rates. While we actively manage our interest rate risk position within policy limits approved by the Board of Directors using strategies established by our ALCO, there can be no assurance that changes in interest rates will not adversely impact our earnings and capital.

The following is a more detailed description of our primary interest rate risks and strategies used to mitigate those risks.

Equity Positioning Risk

The existence of shareholders' equity that serves as an interest-free source of funding for the balance sheet requires us to make decisions about the maturity mix of the assets funded by this equity. Using equity to fund short-term assets results in increased volatility of net interest income, whereas using equity to fund long-term assets results in increased volatility in the market value of our equity. We choose to use this equity to fund intermediate-term assets (generally, maturing equally over five years) to balance the risks to net interest income and market value of equity.

Repricing Risk

Occasionally, mismatches in interest rate repricing of assets and liabilities arise from the interaction of customer business needs, our investment portfolio and liability management activities. Exposure to changes in the level and direction of interest rates is managed by adjusting the asset/liability mix through the use of various interest rate risk management tools, including derivatives. Refer to page 46 for additional information related to derivatives.

Prepayment/Extension Risk

Prepayment risk in our loan portfolio is very limited as approximately 94 percent of our fixed-rate loans contain, at a minimum, make-whole prepayment penalties. These provisions require a borrower to compensate us for the cost we absorb in retiring debt funding associated with the prepayment of loans. This allows us to generally fund our loan assets with debt of similar maturities to manage the risk of prepayments in the loan portfolio.

Prepayment risk in the investment portfolio results when long-term interest rates fall and prepayments increase as underlying borrowers refinance their mortgages to a lower rate. Prepayments adversely affect investment portfolio income in a falling interest rate environment because investments are partially funded with non-callable debt

and any proceeds from prepaid investments will be reinvested at a lower interest rate. Prepayment risk in our investment portfolio is moderate based on the type and average life of securities we purchase for the portfolio. Purchases of mortgage-backed securities are currently subject to a price risk eligibility test based on a stressed interest rate environment. The test is designed to manage our exposure to prepayment risk at the time of investment purchase. In addition, our fixed-rate mortgage-backed securities, other than hybrid-ARMS (adjustable-rate mortgage securities), generally contain some embedded prepayment protection in the form of PAC (planned amortization class) bands. These PAC securities are structured so that principal payments are expected to follow a predetermined schedule as long as the prepayments of the underlying collateral fall within a prescribed band. Over time, these bands may erode resulting in an incremental increase in prepayment risk within the investment portfolio.

We also fund a portion of the prepayable investment portfolio with short-term liabilities that provide a partial hedge against investment prepayments in a falling interest rate environment. The rate we pay on these liabilities will reset downward with a drop in interest rates. Alternatively, we are able to retire these liabilities if prepayments increase on the funded assets.

Extension risk in the investment portfolio occurs when long-term interest rates rise and prepayments decrease more than expected causing the underlying investment securities to pay down at a slower rate than initially expected. In this scenario, investment portfolio income will be negatively impacted as additional higher-rate term funding is required to fund extended securities to maintain the same risk profile. Extension risk in the investment portfolio is moderate based on the type and average life of securities purchased. In the same way PAC bands protect against prepayment risk, they also serve to limit extension risk as the amortization of these securities is defined as long as prepayments of the underlying collateral fall within a prescribed band.

Cap Risk

Cap risk is embedded in the floating-rate mortgage-backed securities in our investment portfolio. When short-term interest rates rise, the interest rate paid by the floating-rate mortgage-backed securities may become capped and limit the amount of income paid by the securities while underlying funding costs are not capped. Exposure to cap risk is managed by monitoring the concentration of strike levels in our floating-rate mortgage-backed securities and related interest rate shock sensitivities. We also purchase interest rate caps and other derivatives to manage exposure to cap risk. In addition, we have the ability to reduce cap risk by selling our floating-rate investment securities.

Basis Risk

Basis risk arises due to the differences between the interest rate indices used to price our assets and the indices used to fund those assets. While we attempt to match all indices, we will always have some basis risk as unanticipated loan volume changes cause an excess or shortage of some

forms of funding. We manage our basis risk through match funding, when possible, and using derivatives (primarily interest rate swaps) and other funding strategies.

Measurement and Monitoring of Interest Rate Risk

We currently utilize several key risk measurement and monitoring tools to assist in the management of interest rate risk. These include interest rate gap analysis, duration gap analysis, sensitivity analysis of net interest income and market value of equity, and net interest income forecasting, each of which is described in further detail on the following pages.

Interest Rate Gap Analysis

The interest rate gap analysis shown in the following table presents a comparison of interest-earning assets and interest-bearing liabilities in defined maturity or repricing timeframes as of December 31, 2010. The interest rate gap analysis is a static indicator that does not reflect future changes in repricing characteristics and may not necessarily indicate the sensitivity of net interest income in a changing interest rate environment.

Interest Rate Sensitivity Analysis at December 31, 2010 (\$ in Millions)

| | One Month or Less | Over One Month Through Six Months | Over Six Months Through One Year | Over One Year but Less Than Five Years | Over Five Years and Not Rate Sensitive | Total |
|--|----------------------|--|---|---|---|------------------|
| Interest-earning Assets: | | | | | | |
| Floating-rate Loans: | | | | | | |
| Adjustable-rate/Indexable-rate Loans | \$ 18,725 | \$ 3,026 | \$ - | \$ - | \$ - | \$ 21,751 |
| Administered-rate Loans | 5,740 | - | - | - | - | 5,740 |
| Fixed-rate Loans: | | | | | | |
| Fixed-rate Loans ⁽¹⁾ | 4,582 | 3,530 | 1,424 | 5,550 | 5,819 | 20,905 |
| Fixed-rate Loans, Prepayable ⁽²⁾ | 20 | 86 | 49 | 550 | 724 | 1,429 |
| Nonaccrual Loans | - | - | - | - | 167 | 167 |
| Total Loans | 29,067 | 6,642 | 1,473 | 6,100 | 6,710 | 49,992 |
| Investment Securities | 4,104 | 1,456 | 1,693 | 3,202 | 2,162 | 12,617 |
| Total Interest-earning Assets ⁽³⁾ | \$ 33,171 | \$ 8,098 | \$ 3,166 | \$ 9,302 | \$ 8,872 | \$ 62,609 |
| Interest-bearing Liabilities: | | | | | | |
| Callable Bonds and Notes | \$ 17 | \$ 178 | \$ 22 | \$ 722 | \$ 2,231 | \$ 3,170 |
| Noncallable Bonds and Notes ⁽⁴⁾ | 10,517 | 12,290 | 7,131 | 17,670 | 8,208 | 55,816 |
| Bonds, Medium Term Notes and Discount Notes ⁽⁴⁾ | 10,534 | 12,468 | 7,153 | 18,392 | 10,439 | 58,986 |
| Effect of Interest Rate Swaps, Forwards, Futures, etc. | 23,053 | (2,698) | (3,870) | (14,185) | (2,300) | - |
| Cash Investment Services Payable and Other | | | | | | |
| Interest-bearing Liabilities | 1,338 | - | - | - | - | 1,338 |
| Total Interest-bearing Liabilities | \$ 34,925 | \$ 9,770 | \$ 3,283 | \$ 4,207 | \$ 8,139 | \$ 60,324 |
| Interest Rate Sensitivity Gap (Total Interest-earning Assets less Total Interest-bearing Liabilities) | \$ (1,754) | \$ (1,672) | \$ (117) | \$ 5,095 | \$ 733 | \$ 2,285 |
| Cumulative Gap | \$ (1,754) | \$ (3,426) | \$ (3,543) | \$ 1,552 | \$ 2,285 | |
| Cumulative Gap/Total Interest-earning Assets | (2.80) % | (5.47) % | (5.66) % | 2.48 % | 3.65 % | |

⁽¹⁾ Prepayment penalties apply that compensate CoBank for economic losses

⁽²⁾ Freely prepayable or only minimal prepayment penalties apply

⁽³⁾ Does not include \$1.9 billion in cash as of December 31, 2010

⁽⁴⁾ Includes subordinated debt

The previous table excludes \$1.9 billion of cash as of December 31, 2010. While cash is not considered an interest-earning asset, we include our cash balance in the sensitivity analysis discussed below, as we would invest such funds in overnight or other highly-liquid investments if market rates increased as depicted in such scenarios. Our interest rate sensitivity position at December 31, 2010 may be characterized as slightly “asset sensitive.” Typically, when our position is asset-sensitive, our net interest income will be favorably impacted in an increasing interest rate environment and when the slope of the yield curve is flatter. This position will be unfavorably impacted in a falling interest rate environment or when the slope of the yield curve is steeper. We have adjusted our position to be slightly asset-sensitive in anticipation of increasing short-term rates over the next few years.

We continually monitor interest rates and have the ability to reposition our balance sheet as a result of anticipated changes in interest rates. For example, if we expected a more immediate and meaningful increase in short-term interest rates, we can increase our asset-sensitive position.

Duration Gap Analysis

The duration gap is the difference between the estimated durations of assets and liabilities, which is calculated using a simulation model. The duration gap summarizes the extent to which estimated cash flows for assets and liabilities are matched, on average, over time. A positive duration gap means there is increased market value exposure to rising interest rates over the long-term because it indicates that the duration of our assets exceeds the duration of our liabilities. A negative duration gap indicates increased exposure to declining interest rates over the long-term because the duration of our assets is less than the duration of our liabilities. We apply the same interest rate process, prepayment models, and volatility assumptions to generate the portfolio duration gap that we use in our sensitivity analysis, which is discussed below. The duration gap provides a relatively concise and simple measure of the interest rate risk inherent in our balance sheet, but it is not directly linked to expected future earnings performance. At December 31, 2010, our aggregate positive duration gap was 2.1 months, compared to 2.9 months at December 31, 2009.

Sensitivity Analysis

We use asset/liability simulation models to evaluate the dynamics of the balance sheet and to estimate earnings volatility under different interest rate environments. These simulations include calculating the impact of significant increases or decreases in interest rates on net interest income, over a twelve month period, and the estimated market value of equity.

Our simulation analysis estimates the effect of immediate and sustained parallel shifts in the yield curve (called “shocks”) of 100, 200 and 300 basis point changes. Pursuant to regulation and our Board policy, when the three-month Treasury rate is below 4 percent, as it was at December 31, 2010, 2009, and 2008, we perform a shock equal to one-half the three-month Treasury rate. This resulted in downward shocks of -6 basis points, -3 basis points, and -6 basis points at

December 31, 2010, 2009, and 2008, respectively. Due to extremely low short-term interest rates, these downward shock scenarios, while required by policy, are not considered meaningful at December 31, 2010, 2009 and 2008. When analyzing net interest income at risk, we also estimate the effect of gradual upward or downward changes in market rates (called “ramps”) over a one year period of 100, 200 and 300 basis point changes, where possible.

The following table summarizes the impact of interest rate risk on net interest income and the market value of equity. Market value of equity is the net present value of all future cash flows discounted to a valuation date, using discounting factors derived from observed market rates on the same valuation date. In all cases, the underlying assumptions and hedging strategies are held constant so that results are comparable from scenario to scenario. However, actual results would differ to the extent changes in strategy were undertaken to mitigate the unfavorable impact of interest rate changes.

| Net Interest Income at Risk | | | |
|------------------------------------|-------------|-------------|-------------|
| December 31, | 2010 | 2009 | 2008 |
| Scenario: | | | |
| - 300 bp shock | n/a | n/a | n/a |
| - 200 bp shock | n/a | n/a | n/a |
| - 100 bp shock | n/a | n/a | n/a |
| - 6 bp shock | - | n/a | (0.3) % |
| - 3 bp shock | n/a | - | n/a |
| + 100 bp shock | 0.2 % | (3.5) % | 0.4 |
| + 200 bp shock | 0.7 | (7.1) | (0.9) |
| + 300 bp shock | 1.1 | (10.9) | (2.0) |
| - 300 bp ramp | n/a | n/a | n/a |
| - 200 bp ramp | n/a | n/a | n/a |
| - 100 bp ramp | n/a | n/a | n/a |
| + 100 bp ramp | 0.1 | (1.2) | 0.8 |
| + 200 bp ramp | 0.7 | (2.4) | 0.8 |
| + 300 bp ramp | 1.4 | (3.7) | 0.6 |

| Market Value of Equity at Risk | | | |
|---------------------------------------|-------------|-------------|-------------|
| December 31, | 2010 | 2009 | 2008 |
| Scenario: | | | |
| - 300 bp shock | n/a | n/a | n/a |
| - 200 bp shock | n/a | n/a | n/a |
| - 100 bp shock | n/a | n/a | n/a |
| - 6 bp shock | 0.2 % | n/a | 0.4 % |
| - 3 bp shock | n/a | 0.1 % | n/a |
| + 100 bp shock | (3.7) | (4.6) | (6.3) |
| + 200 bp shock | (7.2) | (9.3) | (11.8) |
| + 300 bp shock | (10.7) | (13.9) | (16.9) |

Our net interest income is higher in the rising interest rate scenarios due to our asset-sensitive position. Our Board limits the amount of adverse change to net interest income and market value of equity under a 200 basis point rate shock. The limit for market value of equity was 15 percent and the limit for net interest income was 10 percent for all three years presented. At December 31, 2010, 2009 and 2008, we were within our policy limits as detailed in the table above.

Forecasting

We update our simulation model monthly with information on loans, investment securities, borrowings and derivatives. This “current position” is the starting point for all analysis. The current position data is then combined with base case business plan assumptions and independent, third-party economic forecasts for future periods to derive our estimates of future net interest income. Generally, we set assumptions on pricing, maturity characteristics and funding mix using trend analysis of actual asset and liability data.

Net interest income forecasts are derived utilizing different interest rate scenarios. As noted previously, we obtain independent market interest rate projections when preparing our forecasts. These interest rate projections are designed around economic forecasts that are meant to estimate the most likely path of interest rates for the planning horizon and alternate views of a rapidly expanding economy, and a dramatically slowing economy. In addition, we review scenarios based on the market’s implied forward rates and unchanged rates. We also review the impact on net interest income of parallel and nonparallel shifts in the yield curve over different time horizons using stochastic processes, or those involving a randomly determined sequence of observations.

Use of Derivatives

We use derivatives as an integral part of our interest rate risk management activities. To achieve risk management objectives and satisfy the financing needs of our borrowers, we execute various derivative transactions with other financial institutions. Derivatives (primarily interest rate swaps) are used to manage liquidity and the interest rate risk arising from maturity and repricing mismatches between assets and liabilities. In addition, we execute foreign exchange spot and forward contracts to manage currency risk on our relatively nominal amount of loans denominated in foreign currencies. The notional amounts of derivatives, weighted average interest rates to be received and paid, and fair values at December 31, 2010, are shown in the following table. We also discuss derivatives in Note 11 to the accompanying consolidated financial statements.

Derivative Financial Instruments at December 31, 2010 (\$ in Millions)

| Derivative Product | Notional Amount | Weighted Average Receive Rate | Weighted Average Pay Rate | Fair Value |
|-----------------------|------------------|-------------------------------|---------------------------|---------------|
| Receive Fixed Swaps | \$ 25,956 | 2.98 % | 0.26 % | \$ 922 |
| Receive Fixed | | | | |
| Amortizing Swaps | 675 | 3.49 | 0.31 | 36 |
| Pay Fixed Swaps | 1,393 | 0.23 | 1.76 | (24) |
| Pay Fixed | | | | |
| Amortizing Swaps | 675 | 0.31 | 3.27 | (29) |
| Interest Rate Options | 2,056 | - | - | 5 |
| Foreign Currency | | | | |
| Spots and Forwards | 199 | - | - | (1) |
| Total | \$ 30,954 | 2.80 % | 0.41 % | \$ 909 |

We have included a summary of our derivatives portfolio by strategy with further explanation of each strategy in the following section.

Notional Amounts of Derivative Financial Instruments by Strategy (\$ in Millions)

| December 31, | 2010 | 2009 | 2008 |
|--|------------------|------------------|------------------|
| Liquidity Management | \$ 21,474 | \$ 24,325 | \$ 21,365 |
| Equity Positioning | 3,088 | 2,928 | 2,060 |
| Options Risk Management ⁽¹⁾ | 1,850 | 1,500 | 1,500 |
| Customer Transactions | 4,411 | 3,685 | 3,550 |
| Foreign Currency Risk | | | |
| Management ⁽²⁾ | 131 | 128 | 242 |
| Total | \$ 30,954 | \$ 32,566 | \$ 28,717 |

⁽¹⁾ Excludes \$206.0 million, \$100.0 million and \$411.0 million of interest rate options at December 31, 2010, 2009 and 2008, respectively, which are classified as customer transactions.

⁽²⁾ Excludes \$68.0 million, \$90.0 million and \$113.0 million of foreign currency spots and forwards at December 31, 2010, 2009 and 2008, respectively, which are classified as customer transactions.

The total notional amount of our derivatives portfolio decreased by \$1.6 billion in 2010. The decrease was largely due to a lower level of liquidity management derivatives, as a portion of our liquidity objectives were met through the issuance of floating-rate term debt instead of the use of derivatives that convert fixed-rate term debt to floating-rate. This was partially offset by increased options risk management hedging to manage our risk to rising interest rates and higher levels of equity positioning hedging resulting from the Bank’s continued growth in capital.

The total notional amount of our derivatives portfolio increased by \$3.8 billion in 2009 primarily due to actions taken to enhance our liquidity position given the uncertainty in the debt funding markets at that time. This was accomplished by issuing longer-maturity fixed-rate debt and swapping this debt back to short-term repricing instruments that match the repricing frequency of our assets. Without these transactions, the Bank would have to issue short-term debt, resulting in an unacceptable concentration of short-term liabilities. As a result of improvements in the debt funding markets, we have reduced our liquidity position closer to our management target of 180 days.

Liquidity Management

A substantial majority of our interest rate swaps are executed to improve liquidity, primarily by converting specific longer-term fixed-rate bonds and notes into floating-rate debt indexed to LIBOR or similar short-term rates. The fixed rate received on the swap largely offsets the fixed rate paid on the associated debt leaving a net floating rate payment on the swap. This allows us to issue longer-term debt and still match fund the predominantly short-term repricing nature of our interest-sensitive asset portfolio. Liquidity risk management is discussed further beginning on page 48.

Equity Positioning

We also use interest rate swaps to manage interest rate risk as it relates to investment of our equity. If the cash flows of loans and investments on the balance sheet do not create the targeted maturity for the investment of our equity, we enter into receive-fixed interest rate swaps to produce the desired equity investment maturity profile.

Options Risk Management

In the course of managing risk in the investment portfolio, we periodically hedge cap risk embedded within our floating-rate investment securities that do not meet our current risk management objectives. We enter into offsetting derivative transactions to hedge this risk.

Customer Transactions

Derivatives are offered to customers as a service to enable them to modify or reduce their interest rate and foreign exchange risk by transferring such risk to us. We substantially offset this risk transference by concurrently entering into offsetting agreements with counterparties.

Foreign Currency Risk Management

We enter into foreign exchange spot and forward contracts to manage currency risk on our relatively nominal amount of loans denominated in foreign currencies. Typically, foreign currency contracts are purchased to fund the principal cash flows of the loan and simultaneously sold to lock in the principal and interest cash flows upon the repricing or maturity date of the loan.

Counterparty Exposure

The use of derivative instruments exposes us to counterparty credit risk. Credit risk associated with derivatives is measured based on the replacement cost that would be incurred should the counterparties with contracts in a net gain position with respect to CoBank fail to perform. We minimize this risk by diversifying our derivative positions among various counterparties, using master netting agreements, requiring collateral with daily posting and zero thresholds to support credit exposures, evaluating the creditworthiness of each counterparty, establishing individual credit exposure limits and dealing exclusively with counterparties that have an investment grade or better credit rating from a major credit rating agency. In addition, we monitor counterparty credit default swap spreads and other market-related information which may indicate reduced creditworthiness of a counterparty.

We measure counterparty credit risk daily based on the current fair values of our derivative positions. Personnel who are independent of the derivative traders monitor the derivative exposures against approved limits. Exceptions to approved limits are reported to the CLC, along with a plan detailing actions to address limit overages. Any increases to the counterparty limits must be approved by the CLC.

We also perform stress tests on derivatives using simulation models to analyze the potential effects of market rate changes on fair value, including extreme rate changes. The forward interest rate curves used to project the future expected cash flows for the derivative positions are modeled under potential scenarios which increase and decrease interest rates within a 99 percent confidence interval. These extreme rate scenarios are then used to further evaluate potential counterparty credit risk and to establish placement limits.

Notwithstanding our credit evaluation process and the maintenance of collateral agreements with our derivative counterparties, the failure of a counterparty to perform on its obligations could negatively impact our earnings. Furthermore, although our credit evaluations consider the possibility of default by a counterparty, our ultimate exposure to default by a counterparty could be greater than predicted.

The following table details the notional amount of our derivatives and related exposure to dealer counterparties classified by their Standard & Poor's credit rating as of December 31, 2010.

| Derivative Counterparty Exposure (\$ in Millions) | | | | |
|---|----------|-----------|-----------|---------|
| | AAA | AA | A | Below A |
| Exposure to Counterparties | | | | |
| in Net Gain Position | \$ 32 | \$ 613 | \$ 398 | \$ - |
| Collateral Held | 32 | 611 | 389 | - |
| Exposure, Net of Collateral | \$ - | \$ 2 | \$ 9 | \$ - |
| Total Notional Amount | \$ 1,455 | \$ 15,668 | \$ 11,626 | \$ - |
| Total Number of Counterparties | 1 | 7 | 9 | - |

The notional amount of our derivatives and related exposure to customer counterparties were \$2.2 billion and \$77.4 million, respectively, at December 31, 2010. Derivative agreements with our customers are secured through our loan agreements.

Liquidity Risk Management

We must continually raise funds to provide credit and related services to customers, repay maturing debt obligations and meet other obligations.

Our primary source of liquidity is the ability to issue Federal Farm Credit Banks Consolidated Systemwide bonds, medium term notes and discount notes (collectively referred to as Systemwide Debt Securities), as well as the use of available cash. Additionally, if necessary, we could convert high credit quality and liquid investments to cash. As of December 31, 2010, approximately 96 percent of our investment securities contain either an implied or explicit guarantee of the U.S. government, and as such, are considered to be of high credit quality. During 2010, we and other System banks implemented an enhanced liquidity framework wherein a higher level of U.S. Treasury and other U.S. government-guaranteed securities are maintained. Under this framework, the first 15 days of debt coverage must be maintained with cash, cash equivalents and/or U.S. Treasury securities with maturities of less than three years. The next 30 days of debt coverage would come from investment securities with an explicit guarantee from the U.S. government, highly-rated commercial paper and/or federal funds sold that mature in 45 days or less. We were in compliance with the 15 and 45 day liquidity requirements during 2010.

As a result of the System's credit quality and standing in the capital markets as a GSE, we have traditionally had ready access to funding. As discussed in "Liquidity and Capital Resources" beginning on page 51, we have maintained access to the debt-funding markets notwithstanding volatility in the credit markets. See Notes 5 and 15 to the accompanying consolidated financial statements for information regarding interest rates and maturities of Systemwide Debt Securities, and contingencies.

Our liquidity management objectives are to meet maturing debt obligations, provide a reliable source of funding to borrowers, provide additional liquidity if market conditions

deteriorate for a period of time and fund operations on a cost-effective basis. Approximately 71 percent of our interest-earning assets mature or reprice in one year or less with 53 percent maturing or repricing in one month or less. Match-funding these assets from a maturity perspective would create an unacceptable concentration of short-term liabilities. Instead, we manage this risk by issuing longer-term debt and swapping this debt from a fixed to floating rate using derivative transactions, as previously described. By so doing, we reduce the need to fund maturing liabilities on any given business day to a more manageable level. While we believe that sufficient resources are available to meet liquidity management objectives through our debt maturity structure, holdings of liquid assets and access to the capital markets via the Funding Corporation, the volatility of our loan volume could cause our liquidity to vary significantly from day to day.

The amounts and maturities of our debt obligations are set forth in the table below.

| Debt Maturities as of December 31, 2010 (\$ in Millions) | | |
|--|------------------|------------------|
| | Book | Par |
| 1 Day ⁽¹⁾ | \$ 1,338 | \$ 1,338 |
| 2-7 Days | 305 | 305 |
| 8-30 Days | 1,288 | 1,288 |
| 31-90 Days | 4,154 | 4,142 |
| 91-180 Days | 6,044 | 6,035 |
| 181-365 Days | 9,143 | 9,054 |
| 1-5 Years | 26,638 | 26,233 |
| Over 5 Years | 11,414 | 11,043 |
| Total | \$ 60,324 | \$ 59,438 |

⁽¹⁾ Includes \$891.0 million of cash collateral payable to derivative counterparties that does not have a stated maturity date.

Due to the often volatile funding needs of certain customer sectors, in particular certain Agribusiness customer sectors impacted by seasonal borrowing requirements and changing commodity prices, we provide a significant amount of revolving loan commitments. At December 31, 2010, net commitments to extend credit and commercial letters of credit were \$22.6 billion and \$401.6 million, respectively. In addition, we provide standby letters of credit, which guarantee payment or performance of an obligation. As of December 31, 2010, the maximum potential amount of future payments that we may be required to make under standby letters of credit was \$1.5 billion. Since many of these commitments may expire without being drawn, the total commitments do not necessarily represent future cash requirements. Our exposure to many of these commitments is mitigated by borrowing base requirements contained in loan agreements. See Note 10 to the accompanying consolidated financial statements for a full discussion of financial instruments with off-balance sheet risk.

We monitor our liquidity position by assuming no ability to issue debt and calculating the number of days into the future we could meet maturing debt obligations by using available cash and liquidating investments. Our regulator requires us to maintain a minimum of 90 days of liquidity (cash and readily marketable investments generally discounted by 5 to

10 percent of market value) on a continuous basis. Our management target is 180 days of liquidity. During 2010, we averaged 240 days of liquidity compared to an average of 287 days in 2009. As of December 31, 2010, we had 198 days of liquidity, compared to 238 days at December 31, 2009. As debt funding markets have improved, we have managed our liquidity position closer to our target of 180 days.

Our liquidity plan covers certain contingencies in the event our access to normal funding mechanisms is disrupted. As described previously, we have enhanced our liquidity plan by purchasing U.S. Treasury securities. In addition, we purchase only high credit quality investments to ensure the remainder of our investment portfolio is readily marketable and available to serve as a source of funding in the event of disruption to our normal funding mechanisms. Our investment portfolio may also be used as collateral to borrow funds to cover maturing liabilities. FCA regulations require that mortgage- and asset-backed securities be rated triple-A by at least one major rating agency in order to be included as part of our liquidity reserve. As a result of the significant credit deterioration in financial markets, including financial stress on bond insurance companies, certain of our investment securities have been downgraded to ratings below triple-A and are no longer included in our liquidity reserve as of December 31, 2010, as discussed in "Liquidity and Capital Resources" beginning on page 51. We continue to closely monitor market and credit conditions affecting all of our investment securities.

We have identified certain portions of our loan portfolio that we believe could be sold or participated within the period of time our investment portfolio would serve as our primary source of funding. These loan portfolios serve as an additional source of liquidity which would allow us to extend the period of time over which we would not need to access the agency debt funding market. We also maintain uncommitted lines of credit with various financial institutions that could provide liquidity during unanticipated short-term disruptions in funding. However, it is uncertain whether we would be able to sell or participate loans or fully utilize uncommitted lines of credit in the event of a systemic funding disruption.

Operational Risk Management

Operational risk is inherent in all business activities and the management of such risk is important to the achievement of our objectives. Operational risk represents the risk of loss resulting from conducting our operations, including the execution of unauthorized transactions by employees, errors relating to transaction processing and technology, the inability to perfect liens on collateral, breaches of internal control systems and compliance requirements and the risk of fraud by employees or persons outside the Bank. This risk of loss also includes potential legal actions that could arise as a result of operational deficiencies, noncompliance with regulatory standards, employee misconduct or adverse business decisions. In the event of a breakdown in the internal control system, improper operation of systems or improper employee actions, the Bank could incur financial loss or face regulatory action.

We utilize a risk management framework, well-controlled business policies and processes and employee training to manage operational risk. Under this framework, business segments have direct and primary responsibility and accountability for identifying, controlling and monitoring operational risk. Business managers maintain controls with the objective of providing proper transaction authorization and execution, proper system operations, safeguarding of assets from misuse or theft and ensuring the reliability of financial and other data. Employees receive regular training on business ethics, compliance with laws and regulations and information security.

Business continuity and disaster recovery planning is also important to effectively manage our operational risks. Each critical business unit, as well as our Information Technology Division, is required to develop, maintain and test such plans at least annually to ensure that continuity and recovery activities, if needed, could sustain critical functions including systems and information supporting customers and business operations. While we believe that we have designed effective business continuity policies and procedures, there is no absolute assurance that business disruption or operational losses would not occur in the event of a disaster.

Our Risk Management Group is responsible for, among other matters, coordinating the completion of ongoing risk assessments and ensuring that operational risk management is integrated into business decision-making activities. In addition, this group, in coordination with the Audit Committee of the Board of Directors, determines the scope and level of review performed by the internal audit function. Our internal audit function validates the system of internal controls through risk-based, regular and ongoing audit procedures, and reports on the effectiveness of internal controls to executive management and the Audit Committee of the Board of Directors.

To enhance our governance and internal controls, we apply policies and procedures that mirror the material provisions of the Sarbanes-Oxley Act of 2002, including section 404, *Management Assessment of Internal Controls*.

Reputation Risk Management

Reputation risk is the risk to earnings and capital arising from negative public opinion. Such risk encompasses the loss of confidence, trust and esteem among customers, investors, partners, policymakers and other key stakeholders. Like all businesses, the Bank is subject to a wide variety of reputation risk factors both within and outside its control, including credit difficulties with individual customers or industries, business disputes, lawsuits, credit market disruptions, regulatory events and public allegations of misconduct against employees. As a member of the Farm Credit System, the Bank could also be indirectly impacted by events that damage the reputation of another System entity.

The Board of Directors and management regard the Bank's reputation as a critical asset and have implemented a number of policies, procedures and programs to ensure it is well protected. The controls and processes surrounding credit risk, interest rate risk, liquidity risk and operational risk also mitigate reputation risk by lowering the likelihood of significant problems in each of those areas. In addition, the Bank has a formal crisis communications plan in place in order to help it manage communications with stakeholders if an unplanned, reputation-impacting event occurs. The Bank also has a variety of initiatives in place to ensure that customer-owners are communicated with openly and have access to the information they need to accurately evaluate the Bank's overall business and financial performance. Furthermore, customers, Farm Credit partners and others have regular access to members of the Board of Directors and management through the numerous meetings and events held by the Bank throughout the year. We place considerable emphasis on ethical behavior and ensure that our employees receive annual training related to business ethics, compliance with laws and regulations and information security. In addition, as discussed on page 133, each year all employees certify their compliance with our Associate Responsibilities and Conduct Policy. Finally, the Bank actively supports and participates in the Farm Credit System's reputation management committee, which consists of representatives of banks and associations from across the System.

Other Risk Factors

Joint and Several Liability for the Debt of the Farm Credit System

We, along with the other banks in the System, obtain funds for our operations primarily through participating in the issuance of Systemwide Debt Securities by the Funding Corporation. Systemwide Debt Securities are the joint and several liabilities of the System Banks and are not obligations of, nor are they guaranteed by, the U.S. government or any agency or instrumentality thereof, other than the System banks. Under the Farm Credit Act, each System bank is primarily liable for the portion of the Systemwide Debt Securities issued on its behalf. At December 31, 2010, we were primarily liable for \$58.0 billion of Systemwide Debt Securities. Additionally, each System bank is contingently liable for Systemwide Debt Securities of the other System banks. At December 31, 2010, the total aggregate principal amount of the outstanding Systemwide Debt Securities was \$188.8 billion.

Although the System banks have established mutual covenants and measures which are monitored on a quarterly basis, there is no assurance that these would be sufficient to protect a System bank from liability should another System bank default and the Insurance Fund be insufficient to cure the default. See Note 15 to the accompanying consolidated financial statements for a more complete description of the interbank agreements among the System banks.

The Insurance Fund, which totaled \$3.2 billion as of December 31, 2010, is available from the Insurance Corporation to ensure the timely payment by each System bank of its primary obligations on Systemwide Debt Securities. Under the Farm Credit Act, before joint and several liabilities can be invoked, available amounts in the Insurance Fund would first be exhausted. There is no assurance, however, that the Insurance Fund would have sufficient resources to fund a System bank's defaulted obligations. If the Insurance Fund is insufficient, then the remaining System banks must pay the default amount in proportion to their respective available collateral positions. Available collateral approximates the amount of total shareholders' equity of the System banks.

To the extent we must fund our allocated portion of another System bank's portion of the Systemwide Debt Securities due to a default, our earnings and total shareholders' equity would be negatively impacted. The Insurance Corporation does not insure any payments on our subordinated debt, preferred stock or common stock. See Note 5 to the accompanying consolidated financial statements for more information about the Insurance Fund.

Our Funding Costs Would Increase if the Farm Credit System Lost its Status as a Government Sponsored Enterprise

As a member of the System, we have historically benefited from the highly liquid, low-cost debt funding available to us through the Funding Corporation. We (as well as the other System banks) are not legally authorized to accept deposits and therefore cannot use deposits as a funding source. Instead, we raise funds for our lending activities and operations primarily through Systemwide Debt Securities issued on our behalf by the Funding Corporation. As of December 31, 2010, the System's debt securities were rated triple-A by Moody's Investors Service, Standard & Poor's Ratings Services and Fitch Ratings. We are a direct beneficiary of this high investment-grade rating as it relates to the cost of the Systemwide Debt Securities. Additionally, our individual credit ratings are positively impacted by the GSE status of the System.

Liquidity and Capital Resources

Funding

We use our capital and both short-term and long-term borrowings to fund our assets. Other than our subordinated debt, cash investment services obligations and other notes payable, our debt represents CoBank's portion of Systemwide Debt Securities. Refer to Notes 5 and 6 to the accompanying consolidated financial statements for additional information regarding bonds and notes.

As a member of the Farm Credit System, a triple-A rated GSE with continued strong earnings and capital levels, CoBank continues to have ready access to the debt funding markets. While credit markets experienced significant volatility during the credit crisis that began in 2008, our ability to issue debt structures across the yield curve has improved.

As a result of the significant disruption in debt funding markets during the credit crisis, we took actions to enhance our liquidity by issuing longer-term debt and holding higher levels of liquid assets, including cash and short-dated U.S. Treasury securities. As credit markets have improved, we have reduced our liquidity position closer to our management target of 180 days. Our average liquidity was 240 days in 2010 compared to 287 days in 2009. At December 31, 2010, our days liquidity was 198 days compared to 238 days at December 31, 2009.

Liquidity Investments

Investment securities, cash, federal funds sold, securities purchased under resale agreements and other highly-liquid holdings are primarily held for the purposes of maintaining a liquidity reserve and managing short-term surplus funds. As detailed in Note 4 to the accompanying consolidated financial statements, in accordance with Board-approved policies, we purchase high credit quality investments to ensure that the portfolio is readily marketable and available to serve as a source of liquidity in the event of disruption to our normal funding mechanisms.

The two largest housing GSEs, Fannie Mae and Freddie Mac, have been under increased public and congressional scrutiny as a result of their significant operating losses and U.S. government efforts to strengthen their capital and provide liquidity for securities they issue. Congressional deliberations over structural reform related to these housing GSEs are likely to begin in 2011. Although the System has not been the subject of specific congressional scrutiny, and is not subject to the jurisdiction of the same congressional committees as the housing GSEs, it could become subject to similar scrutiny. In the event the System lost its GSE status, or the GSE debt market became so insignificant or investor perception of the strength of our GSE status was reduced, such that the benefit of our GSE status was effectively eliminated, we believe our funding costs, earnings and funding flexibility would be negatively impacted.

We are Subject to Liquidity Risk with Respect to Certain Investments and Derivatives

We are subject to liquidity risk in the course of our investing activities, particularly with respect to our investments in non-agency mortgage-backed securities (Non-Agency securities) and asset-backed securities (ABS), which together represent approximately 4 percent of our investment securities. The markets for Non-Agency securities and ABS, although somewhat improved in 2010, continue to experience illiquidity. Accordingly, it could be difficult to sell such investments, if the need arises, and the discounts from face value would likely be significant. In addition, because of the inherent uncertainty of determining the fair value of investments that do not have a readily available market value, the fair value of our investments may differ significantly from the values that would have been used had a ready market existed for the investments.

Our derivative contracts require the Bank or our counterparties to post cash or securities as collateral when the fair values of the derivatives move based on changes in interest rates. The collateral exchanged between parties occurs daily with zero posting thresholds for all dealer counterparties. As a result of these derivative contracts, we are exposed to liquidity risk when changes in interest rates require us to post collateral to our counterparties. As of December 31, 2010, our counterparties had posted \$891.0 million in cash and \$141.4 million in securities as collateral with us. At December 31, 2010, a 200 basis point parallel increase in the U.S. dollar LIBOR/swap curve would have required us to return substantially all of the collateral currently posted with us by our counterparties, which would reduce our days liquidity. Further increases in interest rates would require us to post collateral with our counterparties, which would also reduce our net collateral ratio.

Investment securities totaled \$12.6 billion at December 31, 2010 as compared to \$11.8 billion at December 31, 2009. As noted previously, at year-end 2010, approximately 96 percent of our investment securities contain either an implied or explicit guarantee of the U.S. government. The following table summarizes our investment securities and related unrealized gains/losses by asset class.

| Investment Securities (\$ in Millions) | | | |
|---|------------------|------------------|----------------|
| | Amortized | Fair | Unrealized |
| December 31, 2010 | Cost | Value | Gains (Losses) |
| U.S. Treasury and Agency Debt | \$ 3,311 | \$ 3,358 | \$ 47 |
| U.S. Agency Mortgage-Backed | 8,673 | 8,739 | 66 |
| Non-Agency Mortgage-Backed | 424 | 402 | (22) |
| Asset-Backed | 143 | 118 | (25) |
| Total | \$ 12,551 | \$ 12,617 | \$ 66 |
| December 31, 2009 | | | |
| U.S. Treasury and Agency Debt | \$ 3,314 | \$ 3,321 | \$ 7 |
| U.S. Agency Mortgage-Backed | 7,616 | 7,740 | 124 |
| Non-Agency Mortgage-Backed | 656 | 574 | (82) |
| Asset-Backed | 225 | 173 | (52) |
| Total | \$ 11,811 | \$ 11,808 | \$ (3) |

We regularly perform impairment assessments of our investment securities based on evaluations of both current and future market and credit conditions. Subsequent changes in market or credit conditions could change these evaluations.

As all of our investment securities are classified as “available for sale”, we recognize changes in the fair value of our investment securities in accumulated other comprehensive income (loss), a component of shareholders’ equity, unless losses are credit-related and considered other-than-temporary, in which case that portion of the loss is recorded in earnings. We recorded unrealized gains of \$69.6 million (\$43.2 million net of tax) and \$170.4 million (\$105.7 million net of tax), respectively, in 2010 and 2009. The unrealized gains in both years primarily relate to the impact of interest rate changes on the values of certain fixed-rate securities.

Credit risk in our investment portfolio is primarily limited to the 4 percent of investment securities that do not contain either an implied or explicit guarantee of the U.S. government, consisting of Non-Agency securities and ABS. The unrealized losses on such securities primarily relate to decreased market liquidity and widened credit spreads. As a result of deteriorating performance and our determination that we could no longer rely on certain bond insurers to meet their contractual obligations related to our home equity ABS they insure, we recorded impairment losses in earnings of \$44.0 million in 2010 and \$15.0 million in 2009. The impairment losses in 2010 related to three Non-Agency securities and seven ABS, and totaled \$8.6 million and \$35.4 million, respectively.

As of December 31, 2010, all of our ABS are composed of home equity securities. These securities are supported by first- or second-lien mortgages and the substantial majority of them are insured by two bond insurance companies that have come under financial stress. In 2009, we determined that we could no longer rely on one of these insurers to fulfill its contractual obligations, which resulted in \$11.0 million of the 2009 impairment losses. During 2010, due to continuing high levels of mortgage defaults and other adverse conditions in the housing market, we determined that we could no longer rely on the other insurer to fulfill all of its obligations to us. This determination resulted in a \$23.0 million impairment loss being recorded in the third quarter of 2010. Increasing levels of defaults and foreclosures on residential mortgages, continued high unemployment, and weak economic conditions may result in further downward adjustments to the fair value of our Non-Agency securities and ABS and the need to record additional impairment losses in earnings.

As previously noted, FCA regulations require that mortgage- and asset-backed securities be rated triple-A by at least one major rating agency in order to be included as part of our liquidity reserve. The total amortized cost and fair value of our Non-Agency MBS and ABS rated below triple-A totaled \$393.5 million and \$349.7 million, respectively, at December 31, 2010. Our non-triple-A rated securities represent 3 percent of our total investment securities as of December 31, 2010. We have received permission from our regulator to continue to hold all securities no longer rated triple-A by at least one major rating agency.

Derivatives

As noted previously, we use derivatives in part to manage our liquidity position. Derivatives are recorded at fair value as assets or liabilities in the accompanying consolidated balance sheets. Changes in the fair value of these derivatives are accounted for as gains or losses through current period earnings or as a component of accumulated other comprehensive income (loss), depending on the use of the derivatives and whether they qualify for hedge accounting treatment. Net changes in the fair value of derivatives and hedged items recorded in the accompanying consolidated statements of income totaled gains of \$2.7 million and \$10.3 million for 2010 and 2009, respectively. The drop in short-term market interest rates across year-end 2008 and into early 2009 created short-term losses on the fair values of certain hedging relationships in late 2008, followed by gains in early 2009 as floating rates on derivatives reset and interest rate levels stabilized. Changes in the fair value of derivatives recorded as other comprehensive income (loss) totaled \$6.3 million (\$3.9 million net of tax) in losses for 2010 and \$0.7 million (\$0.5 million net of tax) in gains for 2009.

Capital

We believe that a sound capital position is critical to our long-term financial success and future growth. We are primarily capitalized by holders of our common and preferred stock and by unallocated retained earnings. Our shareholders' equity increased by \$348.6 million during 2010. This increase was primarily due to \$613.8 million of earnings and a \$34.2 million decrease in accumulated other comprehensive loss, primarily resulting from unrealized gains in our investment portfolio. These factors were partially offset by \$194.1 million in cash patronage, \$63.8 million in preferred stock dividends and \$41.5 million of common stock retirements, net of stock issuances.

In August 2009, we exchanged \$136.8 million of Series A preferred stock for Series D preferred stock. The exchange was completed to enhance the quality and durability of our capital. For regulatory capital purposes, our Series D preferred stock is included in permanent capital, total surplus and core surplus, whereas our Series A preferred stock is included only in permanent capital and total surplus. In connection with the exchange, holders of the Series A preferred stock voted to eliminate certain restrictions on our ability to make open market purchases or exchanges of the Series A preferred stock. The preferred stock exchange is discussed in Note 7 to the accompanying consolidated financial statements.

In September 2008, our shareholders approved a measure allowing CoBank to issue or reissue preferred stock, subject to FCA approval, up to the bylaw limit of \$1.0 billion outstanding, at any time through September 2018. This measure allows us to access outside capital more quickly and efficiently in response to dynamic market conditions, without the necessity of obtaining shareholder approval for each issuance.

In July 2008, we issued \$200 million of Series C non-cumulative subordinated perpetual preferred stock (Series C preferred stock). The net proceeds from this sale of preferred stock were used to increase the Bank's capital and for general corporate purposes. For regulatory capital purposes, our Series C preferred stock is included in permanent capital, total surplus and core surplus. Our preferred stock is discussed in Note 7 to the accompanying consolidated financial statements.

In April 2008, we issued \$500 million of fixed rate unsecured subordinated notes to increase the Bank's regulatory permanent capital and total surplus levels and for general corporate purposes. This issuance, together with the \$500 million of floating rate unsecured subordinated notes issued in 2007, increased our total subordinated debt outstanding to \$1.0 billion, where it remains at December 31, 2010. For regulatory capital purposes, subject to certain limitations, subordinated debt is included in permanent capital and total surplus and excluded from liabilities in the net collateral ratio. Our subordinated debt is discussed in Note 6 to the accompanying consolidated financial statements.

We may from time to time seek to retire our outstanding debt or equity securities through calls, cash purchases and/or exchanges, in open market purchases, privately negotiated transactions or otherwise. Such repurchases or exchanges, if any, will depend on prevailing market conditions, the Bank's liquidity requirements, contractual restrictions and other factors. The amounts involved may be material.

FCA rules and regulations include requirements to maintain regulatory capital at or above minimum levels for our permanent capital ratio, total surplus ratio, core surplus ratio, and net collateral ratio. The calculation of these ratios is summarized in Note 7 to the accompanying consolidated financial statements. If these standards are not met, the FCA could impose restrictions, including limiting a System bank's ability to pay patronage distributions, retire equities and pay preferred stock dividends. As displayed in the following table, at December 31, 2010, 2009 and 2008, we exceeded the minimum regulatory requirements, which are noted parenthetically.

| Selected Capital Information (\$ in Millions) | | | |
|---|----------|----------|----------|
| December 31, | 2010 | 2009 | 2008 |
| Total Shareholders' Equity | \$ 4,406 | \$ 4,058 | \$ 3,595 |
| Total Shareholders' Equity/ Total Assets | 6.69 % | 6.98 % | 5.88 % |
| Permanent Capital Ratio (7.0%) | 14.30 | 15.29 | 14.75 |
| Total Surplus Ratio (7.0%) | 13.96 | 15.01 | 14.61 |
| Core Surplus Ratio (3.5%) | 8.42 | 8.77 | 7.98 |
| Net Collateral Ratio (104.0%)* | 108.03 | 108.67 | 107.75 |

* The regulatory minimum net collateral ratio is 103.0 percent, but the FCA requires the higher 104.0 percent during the period in which we have Series A preferred stock or subordinated debt outstanding.

Effective January 1, 2008, the FCA determined that we should include a significant portion of our common stock as core surplus, subject to certain conditions, on a temporary basis that will likely continue until the earlier of December 31, 2012 or the point at which the FCA changes its capital regulations in a manner that would be inconsistent with this treatment. As a result of this action, our core surplus ratio increased by approximately 1.6 percent. As part of its determination, the FCA requires that we continue to calculate our core surplus ratio excluding common stock and has established a 3.0 percent minimum for such ratio. As of December 31, 2010, our core surplus ratio excluding common stock was 6.54 percent.

In 2007 and 2010, the FCA issued Advance Notices of Proposed Rulemaking on capital adequacy which could ultimately lead to significant changes in the System's regulatory capital rules, including the treatment of a portion of our common stock as core surplus. Any material changes resulting from the process initiated by the proposed rulemaking will be fully disclosed in future reports.

In accordance with the Farm Credit Act, cooperatives and other organizations eligible to borrow are required to purchase equity in CoBank as a condition of borrowing. Eligible borrowers that borrow on a patronage basis have voting rights as long as they are active borrowers. Generally, for borrowers other than affiliated Associations, the minimum initial borrower investment is equal to the lesser of one thousand dollars or 2 percent of the amount of the loan. The minimum initial investment is generally received by CoBank in cash at the time the borrower receives the loan proceeds. Affiliated Associations provide an initial and ongoing voting stock investment of 4 percent of their loan balance. Collectively, the customer-owners that hold voting stock elect our Board of Directors. We operate on a cooperative basis and return a portion of our earnings to our customer-owners in the form of patronage distributions.

In March 2009, our voting shareholders approved changes to our bylaws to convert all previously existing classes of common equity, including non-voting participation certificates, into a single class of common equity – Class A common stock – and to afford voting rights to certain borrowers that are not organized as cooperatives. Class A shareholders that are directly eligible to borrow from CoBank, that borrow on a patronage basis and that are active borrowers have voting rights. All other shareholders do not have voting rights. The number of voting shareholders increased by approximately 27 percent as a result of these bylaw changes, which were effective April 1, 2009.

In conjunction with the annual business and financial planning process, the Board of Directors reviews and approves a capital adequacy plan which includes capital targets and capital ratio baselines. The Board determines a targeted equity level based on projected asset levels, earnings, economic conditions, possible credit losses and other contingencies. The Board also balances the amount required to properly capitalize the Bank with the desire to distribute a level of patronage that provides appropriate returns to our customer-owners. The Board may increase or decrease these patronage levels (provided we remain within the regulatory capital minimums) based on its ongoing evaluation of the Bank’s business. As a result, there is no assurance that patronage will remain at current levels.

When reviewing the capital adequacy plan, the Board considers the following: risk diversification of the loan portfolio, anticipated future capital needs, equity levels required by the Bank’s proprietary economic capital model, the Bank’s capital levels in comparison to commercial banks and the regulatory minimum capital standards. As part of this process, the Board also evaluates the Bank’s projected financial performance under various scenarios, including unanticipated loan growth and prolonged periods of financial and loan quality stress. As of December 31, 2010, internal capital ratio baselines were 10 percent for the permanent capital and total surplus ratios, and 5 percent for the core surplus ratio.

Capital Plans

The Board of Directors approved changes to our cooperative capital plan in 2007, which were effective January 1, 2008, for patronage distributions beginning in March 2009. These changes included a reduction in the target equity level, an extension of the loan base period and elimination of a 7 percent equity level breakpoint for a higher proportion of cash patronage. The target equity level was changed from 10 percent of the five-year historical average loan volume for 2007 to 9 percent of the 10-year historical average loan volume for 2008 and then 8 percent for 2009. Additionally, when a borrower’s loans are paid in full, stock will be retired over this same 10-year loan base period beginning in the year following loan payoff, subject to Board approval and compliance with minimum regulatory capital requirements.

The targeted patronage rate for the cooperative capital plan is expected to remain at 1 percent of the current year average loan volume. Beginning with the 2008 patronage paid in March 2009, the cash portion of patronage was 65 percent for all cooperative capital plan members. Previously, the level of cash patronage was 80 percent for those members whose equity level was greater than 7 percent and 50 percent for the remaining cooperative capital plan members.

All patronage payments and retirements of equity require the prior approval of our Board of Directors, which has increased or decreased such payments based upon the Bank’s current or projected business performance and capital levels. In addition, patronage payments can only be made if the Bank is in compliance with minimum regulatory capital requirements.

Patronage distributions are made in the form of cash and common stock, as shown in the following table. Eligible shareholders will receive patronage distributions from CoBank for 2010 in the first quarter of 2011. Patronage distributions were higher for 2010 as compared to 2009 due to an increase in the level of patronage-based agribusiness and rural energy average loan volume as compared to 2009.

| Patronage Distributions (\$ in Thousands) | | | |
|--|-------------------|-------------------|-------------------|
| Year Ended December 31, | 2010 | 2009 | 2008 |
| Common Stock | \$ 90,450 | \$ 85,067 | \$ 106,681 |
| Cash | 194,110 | 183,828 | 207,216 |
| Total Patronage Distributions | \$ 284,560 | \$ 268,895 | \$ 313,897 |
| Patronage Distributions/ Total Average Common Stock | | | |
| Owned by Active Borrowers | 19.77 % | 19.68 % | 25.10 % |

Economic Capital

Economic capital is a measure of risk and is defined as the amount of capital required to absorb potential losses resulting from extremely severe events over a one-year time period. “Unexpected losses” are the difference between potential extremely severe losses and the expected (average) loss over a one-year time period. The amount of economic capital required is based on our risk profile and a targeted solvency standard. For economic capital modeling purposes, we have targeted a “AA” solvency standard, which equates to a 99.97% confidence level. In other words, the likelihood of incurring losses greater than the required economic capital amount is estimated to be similar to the likelihood of a AA-rated bond defaulting, which is a 0.03% probability.

We attribute economic capital to credit risk, interest rate risk, operational risk and market risk. Credit risk, interest rate risk and operational risk are described under “Corporate Risk Profile” beginning on page 38. Market risk represents exposure to asset residual values related to our leasing activity. These risks are measured and aggregated to estimate the exposure to potential extremely severe events and any impact to our level or composition of capital.

We, like the other System banks, utilize economic capital software, including similar conceptual designs and modeling methodologies. System bank risk management and financial management personnel, in consultation with industry experts, jointly developed methodologies and assumptions used to measure economic capital. The modeling considers the economic capital requirements of Associations in each of the System bank districts through the evaluation of the Associations’ retail credit risk, operational risk and interest rate risk. An economic capital shortfall (which is the difference between available capital and required economic capital) at any Association is included in the district bank’s economic capital requirements. All System bank models are calibrated to achieve a standard of default protection equivalent to a AA-rated institution. At December 31, 2010, the Bank held capital that was greater than its economic capital model requirement.

Credit Risk Capital

Credit risk capital requirements are based on the risk profile of the borrower or counterparty, repayment sources, the nature of underlying collateral and other support, given current events and conditions. Our credit risk ratings process uses a two dimensional loan rating structure, incorporating our 14-point risk-rating scale to identify and track the probability of borrower default and a separate scale addressing loss given default.

In assigning credit risk capital, our economic capital model considers retail borrower probability of default, loss given default, and portfolio concentrations. Other principal drivers of credit risk that differentiate capital allocation include exposure at default, asset maturity, and asset and inter-commodity correlations. We have developed standards for probability of borrower default and loss given default, based on external benchmarks.

Interest Rate Risk Capital

The amount of capital attributed to interest rate risk is based on potential changes in our market value of equity, calculated under randomly generated interest rate scenarios. We utilize widely accepted, third-party models to quantify the interest rate risk and related risk capital requirement.

Operational Risk Capital

Our approach to quantifying operational risk capital is based on the capital of non-financial companies with similar business risks. These non-financial companies hold capital primarily for operational risk. Their level of capital and credit rating yields an inferred estimate of the level of capital to be held for operational risk. Capital as a percent of operating expenses is the primary methodology used in determining operational risk capital.

Market Risk Capital

Market risk arises primarily from the volatility in the residual value of leased assets at the maturity of lease contracts. This risk exists because of the mismatch between the present value of future cash flows, the present value of the returned leased asset, and the underlying value of the equipment over time. This is because default can occur when the inherent value of the leased asset is below that of the present value of all future payments. This difference is used to calculate the exposure.

Other Risks

Other areas of risk in which we may have exposure are structural, liquidity, regulatory, reputation, and political risk. While capital is not specifically attributed to these risks, some of the excess capital – the amount by which book capital exceeds economic capital – is held for these other risks.

Critical Accounting Estimates

Management’s discussion and analysis of the financial condition and results of operations are based on the Bank’s consolidated financial statements, which we prepare in accordance with accounting principles generally accepted in the United States of America. In preparing these financial statements, we make estimates and assumptions. Our financial position and results of operations are affected by these estimates and assumptions, which are integral to understanding reported results.

Note 2 to the accompanying consolidated financial statements contains a summary of our significant accounting policies. We consider certain of these policies to be critical to the presentation of our financial condition, as they require us to make complex or subjective judgments that affect the value of certain assets and liabilities. Some of these estimates relate to matters that are inherently uncertain. Most accounting policies are not, however, considered critical. Our critical accounting policies relate to determining the level of our reserve for credit exposure and the valuation of financial instruments with no ready markets (primarily derivatives and certain investment securities). Management has reviewed these critical accounting policies with the Audit Committee of the Board of Directors.

Certain of the statements below contain forward-looking statements, which are more fully discussed on page 59.

Reserve for Credit Exposure

Our allowance for loan losses reflects an adjustment to the value of our total loan and finance lease portfolio for inherent credit losses, while we also maintain a separate reserve for unfunded commitments. This reserve is reported as a liability on the Bank's consolidated balance sheet. We refer to the combined amounts of the allowance for loan losses and the reserve for unfunded commitments as the "reserve for credit exposure."

Our reserve for credit exposure reflects our assessment of the risk of probable and estimable loss related to outstanding balances and unfunded commitments in our loan and finance lease portfolio. The reserve for credit exposure is maintained at a level consistent with this assessment, considering such factors as loss experience, portfolio quality, portfolio concentrations, current production conditions, and economic and environmental factors specific to our business segments.

The reserve for credit exposure is based on our regular evaluation of our loan and finance lease portfolio. We establish the reserve for credit exposure via a process that begins with estimates of probable loss within the portfolio. Our methodology consists of analysis of specific individual credits and evaluation of the remaining portfolio. We evaluate significant individual credit exposures, including adversely classified loans, based upon the borrower's overall financial condition, resources, payment record and projected viability. We also evaluate the prospects for support from any financially viable guarantors and the estimated net realizable value of any collateral. Senior-level committees approve specific credit and reserve-related activities. The Audit and Risk Committees of the Board of Directors review and separately approve the reserve for credit exposure prior to final approval by the Board of Directors.

Our determination of the reserve for credit exposure is sensitive to the assigned risk ratings and probabilities of default, as well as assumptions surrounding loss given default. Changes in these components underlying this critical accounting estimate could increase or decrease our provision for loan losses. Such a change would increase or decrease net income and the related allowance for loan losses and reserve for unfunded commitments, which could have a material effect on the Bank's financial position and results of operations.

To analyze the impact of assumptions on our provision expense and the related reserve for credit exposure, we changed a critical assumption to reflect the impact of deterioration or improvement in loan quality. In the event that 10 percent of loans and finance leases, excluding loans to Associations and guaranteed loans, experienced downgrades or upgrades of one risk rating category, the provision for loan losses and related reserve for credit exposure would have increased or decreased by \$26.0 million at December 31, 2010.

As discussed in Note 2 to the accompanying consolidated financial statements, we refined our methodology for determining the allowance for loan losses in 2008.

Valuation of Financial Instruments with No Ready Markets

We use fair value measurements to record fair value adjustments to certain financial instruments and to determine fair value disclosures. All of our investment securities and derivative instruments are reported at their estimated fair value on the accompanying consolidated balance sheets.

As discussed in Note 12 to the accompanying consolidated financial statements, we maximize the use of observable inputs when measuring fair value. Observable inputs reflect market-derived or market-based information obtained from independent sources, while unobservable inputs primarily reflect our estimates about market data.

The fair value of the majority of our investment securities is determined by a third-party pricing service that uses valuation models to estimate current market prices. Inputs and assumptions related to these models are typically observable in the marketplace. Such models incorporate prepayment assumptions and underlying mortgage- or asset-backed collateral information to generate cash flows that are discounted using appropriate benchmark interest rate curves and volatilities. These third-party valuation models also incorporate information regarding broker/dealer quotes, available trade information, historical cash flows, credit ratings, and other market information. Such valuations represent an estimated exit price, or price to be received by a seller in active markets to sell the investment securities to a willing participant.

Based on the lack of active trading volume for asset-backed securities, the fair value of our ABS are calculated internally using third-party models, with certain adjustments made in consideration of third-party pricing service results. Inputs into these valuation models include underlying collateral data and projected losses as well as information for prepayment speeds and discounting spreads. Due to the lack of marketplace information, the inputs into these valuation models primarily represent management assumptions, with some corroboration to observable market inputs.

The fair value of our derivative financial instruments is the estimated amount to be received to sell a derivative asset or paid to transfer or extinguish a derivative liability in active markets among willing participants at the reporting date. Estimated fair values are determined through internal market valuation models. These models incorporate benchmark interest rate curves, volatilities, counterparty credit quality, and other inputs that are observable directly or indirectly in the marketplace. We compare internally calculated derivative valuations to broker/dealer quotes to substantiate the results.

All financial models used for the determination of the fair value of financial instruments in the financial statements or for independent risk monitoring purposes are periodically reviewed and validated in accordance with our policies.

The degree of management judgment involved in determining the fair value of a financial instrument is dependent upon the availability of observable market inputs. For financial instruments that trade actively and have observable market prices and inputs, there is minimal subjectivity involved in measuring fair value. When observable market prices and inputs are not fully available, management judgment is necessary to estimate fair value. In addition, changes in market conditions may reduce the availability of market prices or observable data. For example, reduced liquidity in the capital markets or changes in secondary market activities could result in observable market inputs becoming unavailable. When market data is not available, we use valuation techniques requiring more management judgment to estimate the appropriate fair value measurement. Changes in assumptions could affect the fair values.

At December 31, 2010, approximately 21 percent of total assets, or \$13.7 billion, consisted of financial instruments recorded at fair value. Approximately 99 percent of these financial instruments used valuation methodologies involving market-based or market-derived information to measure fair value. The remaining 1 percent of these financial instruments is measured using model-based techniques, constituting our entire asset-backed securities portfolio. At December 31, 2010, approximately 2 percent of total liabilities, or \$1.0 billion, consisted of financial instruments recorded at fair value.

Recent Accounting Pronouncements

In July 2010, the Financial Accounting Standards Board (FASB) issued provisions concerning disclosures about the credit quality of financing receivables and the allowance for credit losses. Enhanced disclosures are required on a disaggregated basis at two levels – portfolio segment and class of financing receivable. Effective December 31, 2010, we adopted these disclosure provisions issued by the FASB. As noted previously, our allowance for loan losses and reserve for unfunded commitments are collectively referred to as our reserve for credit exposure. See Note 3 to the accompanying consolidated financial statements for our disclosures related to the credit quality of financing receivables and the reserve for credit exposure.

In June 2009, the FASB issued provisions concerning accounting for transfers of financial assets. These provisions clarify whether a transferor has surrendered control over transferred financial assets, and establish specific conditions for reporting a transfer of a portion of a financial asset as a sale. Enhanced disclosures are required for transfers of financial assets that are deemed to be secured borrowings and for a transferor's continuing involvement with transferred financial assets. The accounting requirements were effective for interim and annual reporting periods beginning after November 15, 2009, and were applicable to transfers occurring on or after the effective date. We adopted the new requirements effective January 1, 2010. The adoption of these new provisions had no material impact on our consolidated financial position, results of operations or cash flows.

Recent Developments

Proposed Merger with U.S. AgBank, FCB

In December 2010, the CoBank Board of Directors unanimously approved a Letter of Intent to pursue a merger with U.S. AgBank, FCB, one of the four other banks in the System. The merged bank would serve as a wholesale provider of financing to Farm Credit Associations that provide credit and financial services to more than 70,000 farmers, ranchers and other rural borrowers in 23 states. It would also serve as a direct lender to agribusinesses and rural electric, water and communications service providers throughout the country. The merged bank would continue to do business under the CoBank name and be headquartered outside Denver, Colorado. Robert B. Engel, CoBank's president and chief executive officer, would be the president and chief executive of the merged bank. The proposed merger transaction is subject to several conditions, including the approval of both banks' shareholders as well as our regulator. U.S. AgBank, whose Board of Directors also unanimously approved the Letter of Intent to merge, had total assets of \$25.4 billion and capital of \$1.4 billion at December 31, 2010.

Financial Regulatory Reform

The Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law in July 2010. The System's regulatory structure remains unchanged and the System will not be subject to the new regulatory oversight authorities created by the new law. However, the new law contains mandatory derivatives clearing requirements that may ultimately be applicable to CoBank and other System entities. In the event that CoBank is required to transact its derivatives through a clearinghouse, our net funding costs could increase.

Business Outlook

Our Board of Directors and management are committed to continuing our strong financial and operating performance and to fulfilling our mission to serve as a dependable provider of credit and other financial services to vital industries across rural America.

Our continued success will be achieved by delivering on our value proposition, creating opportunities to partner with other System institutions, increasing market share, maintaining effective access to the agency debt capital markets, optimizing current lending authorities and pursuing various strategic alliances with other financial services organizations.

We began to see a modest improvement in the U.S. economy in 2010. The nation's gross domestic product grew throughout the year, jobs were created and profitability improved for many U.S. companies. Despite these trends, CoBank remains cautious about the strength and sustainability of the economic recovery. GDP and job growth rates, while positive, are anemic by historical standards. And customers in several of the industries we serve continue to feel the impact of unpredictable and increasingly volatile agricultural commodity prices, a continued weak housing market, and regulatory and political uncertainty. These economic and other challenges for our customers could reduce the credit quality of our lending portfolio. Additionally, continued weakness in the housing market and/or persistently high unemployment could lead to further losses on our non-agency investment securities.

Notwithstanding the conditions noted previously, we are well capitalized and our liquidity position remains strong. We will continue our disciplined approach to managing risk and will closely monitor asset quality while emphasizing effective enterprise-wide management of credit, interest rate, liquidity, operational and reputation risks. We will also continue to enhance our financial condition through prudent expense discipline and the retention of a portion of our earnings.

We believe CoBank continues to experience significant opportunities across all the industries we serve. Under the guidance of our Board of Directors and through the focus of a proven executive management team, we look forward to continuing to deliver on our value proposition on behalf of our customers and to fulfilling our mission as a dependable and strategic source of credit and financial services to the nation's rural economy.

Forward Looking Statements

Certain of the statements contained in the 2010 Annual Report that are not historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act. Our actual results may differ materially from those included in the forward-looking statements that relate to our plans, projections, expectations and intentions. Forward-looking statements are typically identified by words such as “believe,” “expect,” “anticipate,” “intend,” “estimate,” “plan,” “project,” “may,” “will,” “should,” “would,” “could” or similar expressions. Although we believe that the information expressed or implied in such forward-looking statements is reasonable, we can give no assurance that such projections and expectations will be realized or the extent to which a particular plan, projection or expectation may be realized. These forward-looking statements are based on current knowledge and are subject to various risks and uncertainties, including, but not limited to:

- Fluctuations in the agricultural, energy, communications, water, international and leasing sectors;
- Weak U.S. and global economic conditions;
- Legislative and regulatory actions;
- Government policies and developments in the U.S. and other countries in which we make loans;
- The effect of banking and financial services reforms;
- Possible amendments to, and interpretations of, risk-based capital guidelines;
- Environmental-related conditions or laws impacting our lending activities;
- Changes in the U.S. government’s support of the agriculture industry;
- Actions taken by the U.S. Congress relative to GSEs, including Fannie Mae and Freddie Mac;
- Actions taken by the U.S. government to manage fiscal policy;
- Actions taken by the Federal Reserve to manage the monetary policy of the U.S.;
- The level of interest rates;
- Relationships between various interest rate indices;
- Changes in assumptions underlying the valuations of financial instruments;
- Changes in the bases for our estimates underlying the reserve for credit exposure;
- Credit performance of the loan portfolios, portfolio growth and seasonal factors;
- Failure of our investment portfolio to perform as expected or deterioration in the credit quality of such investments;
- The resolution of legal proceedings and related matters;
- Weather-related, disease and other adverse climatic or biological conditions that periodically occur that impact agricultural productivity and income;
- Nonperformance by counterparties to our derivative positions; and
- Our ability to successfully complete, integrate and profitably operate any business combinations or strategic alliances, including the potential merger discussed on page 57.

We expressly disclaim any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

Consolidated Income Statements

CoBank, ACB

(\$ in Thousands)

| Year Ended December 31, | 2010 | 2009 | 2008 |
|--|--------------|--------------|--------------|
| Interest Income | | | |
| Loans | \$ 1,408,565 | \$ 1,446,663 | \$ 2,137,890 |
| Investment Securities | 257,739 | 329,283 | 453,127 |
| Federal Funds Sold, Securities Purchased Under Resale Agreements and Other | 1 | 61 | 12,087 |
| Total Interest Income | 1,666,305 | 1,776,007 | 2,603,104 |
| Interest Expense | 715,460 | 830,044 | 1,740,495 |
| Net Interest Income | 950,845 | 945,963 | 862,609 |
| Provision for Loan Losses | 60,000 | 80,000 | 55,000 |
| Net Interest Income After Provision for Loan Losses | 890,845 | 865,963 | 807,609 |
| Noninterest Income/ Expense | | | |
| Net Fee Income | 102,620 | 89,947 | 63,734 |
| Prepayment Income | 18,820 | 13,745 | 28,056 |
| Losses on Early Extinguishments of Debt | (26,537) | (18,234) | (33,165) |
| Total Other-Than-Temporary Impairment Losses | (49,851) | (48,036) | (6,000) |
| Portion of Loss Recognized in Other Comprehensive Loss | 5,851 | 33,036 | - |
| Net Other-Than-Temporary Impairment Losses Included in Earnings | (44,000) | (15,000) | (6,000) |
| Other, Net | 47,656 | 14,503 | 15,786 |
| Total Noninterest Income | 98,559 | 84,961 | 68,411 |
| Operating Expenses | | | |
| Employee Compensation | 98,971 | 101,868 | 100,998 |
| Insurance Fund Premium | 13,281 | 53,968 | 50,476 |
| Information Services | 16,115 | 16,387 | 17,721 |
| General and Administrative | 42,789 | 17,093 | 15,001 |
| Purchased Services | 20,559 | 7,578 | 8,469 |
| Occupancy and Equipment | 6,479 | 6,806 | 7,054 |
| Travel and Entertainment | 10,922 | 8,895 | 9,544 |
| Farm Credit System Related | 7,094 | 6,636 | 5,918 |
| Total Operating Expenses | 216,210 | 219,231 | 215,181 |
| Income Before Income Taxes | 773,194 | 731,693 | 660,839 |
| Provision for Income Taxes | 159,427 | 166,277 | 127,406 |
| Net Income | \$ 613,767 | \$ 565,416 | \$ 533,433 |

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Balance Sheets

CoBank, ACB

(\$ in Thousands)

| As of December 31, | 2010 | 2009 | 2008 |
|--|----------------------|----------------------|----------------------|
| Assets | | | |
| Total Loans | \$ 49,992,338 | \$ 44,174,464 | \$ 44,550,121 |
| Less: Allowance for Loan Losses | 400,744 | 369,817 | 329,198 |
| Net Loans | 49,591,594 | 43,804,647 | 44,220,923 |
| Cash | 1,922,586 | 923,083 | 3,127,204 |
| Investment Securities | 12,616,696 | 11,808,207 | 11,536,848 |
| Federal Funds Sold, Securities Purchased Under Resale Agreements and Other | - | 5,000 | 5,000 |
| Accrued Interest Receivable | 386,401 | 406,700 | 350,134 |
| Interest Rate Swaps and Other Financial Instruments | 1,001,365 | 984,074 | 1,674,753 |
| Other Assets | 307,248 | 228,991 | 247,195 |
| Total Assets | \$ 65,825,890 | \$ 58,160,702 | \$ 61,162,057 |
| Liabilities | | | |
| Bonds and Notes | \$ 59,324,313 | \$ 51,911,314 | \$ 55,365,422 |
| Subordinated Debt | 1,000,000 | 1,000,000 | 1,000,000 |
| Accrued Interest Payable | 351,235 | 394,298 | 446,524 |
| Interest Rate Swaps and Other Financial Instruments | 92,580 | 123,379 | 140,948 |
| Reserve for Unfunded Commitments | 99,799 | 128,373 | 154,223 |
| Other Liabilities | 551,766 | 545,709 | 460,091 |
| Total Liabilities | 61,419,693 | 54,103,073 | 57,567,208 |
| Commitments and Contingent Liabilities (Note 15) | | | |
| Shareholders' Equity | | | |
| Preferred Stock | 700,000 | 700,000 | 700,000 |
| Common Stock (Note 7) | 1,568,989 | 1,520,054 | 1,401,192 |
| Unallocated Retained Earnings | 2,137,394 | 1,871,986 | 1,638,596 |
| Accumulated Other Comprehensive Loss | (186) | (34,411) | (144,939) |
| Total Shareholders' Equity | 4,406,197 | 4,057,629 | 3,594,849 |
| Total Liabilities and Shareholders' Equity | \$ 65,825,890 | \$ 58,160,702 | \$ 61,162,057 |

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statements of Cash Flows

CoBank, ACB

(\$ in Thousands)

| Year Ended December 31, | 2010 | 2009 | 2008 |
|--|---------------------|--------------------|---------------------|
| Cash Flows Provided by Operating Activities | | | |
| Net Income | \$ 613,767 | \$ 565,416 | \$ 533,433 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: | | | |
| Provision for Loan Losses | 60,000 | 80,000 | 55,000 |
| Deferred Income Taxes | 27,237 | 61,409 | 73,845 |
| Depreciation and Amortization/Accretion, Net | 3,568 | (7,009) | 10,651 |
| Losses on Impairments of Investments Available-for-Sale | 44,000 | 15,000 | 6,000 |
| Decrease (Increase) in Accrued Interest Receivable | 20,299 | (56,566) | (22,595) |
| Increase in Other Assets | (67,906) | (6,419) | (5,360) |
| Decrease in Accrued Interest Payable | (43,063) | (52,226) | (20,681) |
| (Decrease) Increase in Other Liabilities | (50,495) | 15,811 | (11,074) |
| Net (Gains) Losses on Interest Rate Swaps and Other Financial Instruments | (1,448) | (10,002) | 6,622 |
| Proceeds from Termination of Interest Rate Swaps | - | 7,222 | 64,765 |
| Other | (7,896) | (1,318) | (819) |
| Net Cash Provided by Operating Activities | 598,063 | 611,318 | 689,787 |
| Cash Flows (Used in) Provided by Investing Activities | | | |
| Net (Increase) Decrease in Loans | (5,871,365) | 302,797 | (4,073,978) |
| Net Decrease in Federal Funds Sold, Securities Purchased Under Resale Agreements and Other | 5,000 | - | 642,400 |
| Investment Securities: | | | |
| Purchases | (14,332,036) | (9,875,713) | (5,928,986) |
| Proceeds from Maturities and Prepayments | 13,542,385 | 9,760,110 | 4,685,768 |
| Proceeds from Sales | - | 3,396 | - |
| Net Cash (Used in) Provided by Investing Activities | (6,656,016) | 190,590 | (4,674,796) |
| Cash Flows Provided by (Used in) Financing Activities | | | |
| Bonds and Notes Proceeds | 40,122,110 | 21,260,036 | 98,458,551 |
| Bonds and Notes Retired | (32,487,178) | (23,530,769) | (93,522,202) |
| Net Issuance of Subordinated Debt | - | - | 496,750 |
| Net (Decrease) Increase in Notes Payable and Other Interest-bearing Liabilities | (286,222) | (497,484) | 1,641,144 |
| (Cost) Proceeds from (Exchange) Issuance of Preferred Stock, Net | - | (2,176) | 197,553 |
| Preferred Stock Dividends Paid | (63,799) | (59,866) | (48,075) |
| Common Stock Issued | 2,465 | 41,321 | 43,848 |
| Common Stock Retired | (43,980) | (7,526) | (40,758) |
| Cash Patronage Distribution Paid | (185,940) | (209,565) | (155,013) |
| Net Cash Provided by (Used In) Financing Activities | 7,057,456 | (3,006,029) | 7,071,798 |
| Net Increase (Decrease) in Cash | 999,503 | (2,204,121) | 3,086,789 |
| Cash at Beginning of Year | 923,083 | 3,127,204 | 40,415 |
| Cash at End of Year | \$ 1,922,586 | \$ 923,083 | \$ 3,127,204 |
| Supplemental Noncash Investing and Financing Activities | | | |
| Net Change in Accrued Purchases of Securities | \$ 6,002 | \$ (6,002) | \$ - |
| Decrease (Increase) in Net Unrealized Losses on Investment Securities, Before Taxes | 69,608 | 170,418 | (137,626) |
| Patronage in Common Stock | 90,450 | 85,067 | 106,681 |
| Supplemental Noncash Fair Value Changes Related to Hedging Activities | | | |
| (Increase) Decrease in Interest Rate Swaps and Other Financial Instrument Assets | \$ (17,291) | \$ 690,679 | \$ (1,219,141) |
| Increase (Decrease) in Bonds and Notes Related to Hedging Activities | 49,182 | (691,663) | 1,143,781 |
| (Decrease) Increase in Interest Rate Swaps and Other Financial Instrument Liabilities | (30,799) | (17,569) | 84,125 |
| Supplemental Disclosure of Cash Flow Information | | | |
| Interest Paid | \$ 755,518 | \$ 886,875 | \$ 1,775,991 |
| Income Taxes Paid | 213,793 | 85,591 | 22,454 |

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity

CoBank, ACB

(\$ in Thousands)

| | Preferred Stock | Common Stock | Unallocated Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|--|-----------------|--------------|-------------------------------|---|----------------------------|
| Balance at December 31, 2007 | \$ 500,000 | \$ 1,291,421 | \$ 1,470,191 | \$ (28,188) | \$ 3,233,424 |
| Adjustment for the Adoption of a New Accounting Pronouncement (Note 8) | | | (609) | | (609) |
| Balance at Beginning of Period, as Adjusted | 500,000 | 1,291,421 | 1,469,582 | (28,188) | 3,232,815 |
| Comprehensive Income: | | | | | |
| Net Income | | | 533,433 | | 533,433 |
| Other Comprehensive Income, Net of Taxes: | | | | | |
| Net Change in Unrealized Losses on Investment Securities | | | | (85,328) | (85,328) |
| Net Change in Unrealized Losses on Interest Rate Swaps and Other Financial Instruments | | | | (1,025) | (1,025) |
| Net Pension Adjustment | | | | (30,398) | (30,398) |
| Comprehensive Income | | | | | 416,682 |
| Preferred Stock Issued | 200,000 | | | | 200,000 |
| Preferred Stock Issuance Costs | | | (2,447) | | (2,447) |
| Preferred Stock Dividends | | | (48,075) | | (48,075) |
| Common Stock Issued, Net | | 3,090 | | | 3,090 |
| Patronage Distribution: | | | | | |
| Cash | | | (207,216) | | (207,216) |
| Common Stock | | 106,681 | (106,681) | | - |
| Balance at December 31, 2008 | \$ 700,000 | \$ 1,401,192 | \$ 1,638,596 | \$ (144,939) | \$ 3,594,849 |
| Comprehensive Income: | | | | | |
| Net Income | | | 565,416 | | 565,416 |
| Other Comprehensive Income, Net of Taxes: | | | | | |
| Net Change in Unrealized Losses on Investment Securities | | | | | |
| Not Other-Than-Temporarily Impaired | | | | 134,717 | 134,717 |
| Other-Than-Temporarily Impaired Investment Securities | | | | (29,058) | (29,058) |
| Net Change in Unrealized Losses on Interest Rate Swaps and Other Financial Instruments | | | | 455 | 455 |
| Net Pension Adjustment | | | | 4,414 | 4,414 |
| Comprehensive Income | | | | | 675,944 |
| Preferred Stock Dividends | | | (60,955) | | (60,955) |
| Preferred Stock Exchange Costs | | | (2,176) | | (2,176) |
| Common Stock Issued, Net | | 33,795 | | | 33,795 |
| Patronage Distribution: | | | | | |
| Cash | | | (183,828) | | (183,828) |
| Common Stock | | 85,067 | (85,067) | | - |
| Balance at December 31, 2009 | \$ 700,000 | \$ 1,520,054 | \$ 1,871,986 | \$ (34,411) | \$ 4,057,629 |

(Table continues on the following page)

Consolidated Statements of Changes in Shareholders' Equity (Continued)

CoBank, ACB

(\$ in Thousands)

| | Preferred Stock | Common Stock | Unallocated Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity |
|--|-----------------|--------------|-------------------------------|---|----------------------------|
| Balance at December 31, 2009 | \$ 700,000 | \$ 1,520,054 | \$ 1,871,986 | \$ (34,411) | \$ 4,057,629 |
| Comprehensive Income: | | | | | |
| Net Income | | | 613,767 | | 613,767 |
| Other Comprehensive Income, Net of Taxes: | | | | | |
| Net Change in Unrealized Losses on Investment Securities | | | | | |
| Not Other-Than-Temporarily Impaired | | | | 42,010 | 42,010 |
| Other-Than-Temporarily Impaired Investment Securities | | | | 1,147 | 1,147 |
| Net Change in Unrealized Losses on Interest Rate Swaps and Other Financial Instruments | | | | (3,893) | (3,893) |
| Net Pension Adjustment | | | | (5,039) | (5,039) |
| Comprehensive Income | | | | | 647,992 |
| Preferred Stock Dividends | | | (63,799) | | (63,799) |
| Common Stock Retired, Net | | (41,515) | | | (41,515) |
| Patronage Distribution: | | | | | |
| Cash | | | (194,110) | | (194,110) |
| Common Stock | | 90,450 | (90,450) | | - |
| Balance at December 31, 2010 | \$ 700,000 | \$ 1,568,989 | \$ 2,137,394 | \$ (186) | \$ 4,406,197 |

The accompanying notes are an integral part of the consolidated financial statements.

Notes to Consolidated Financial Statements

CoBank, ACB

(\$ in Thousands, Except Per Share Amounts and as Noted)

Note 1 – Organization

CoBank, ACB (CoBank or the Bank) is one of the five banks of the Farm Credit System (System). CoBank provides loans, leases and other financial services to vital industries across rural America. The System is a federally chartered network of borrower-owned lending institutions composed of cooperatives and related service organizations. The System was established in 1916 by the United States Congress and is a Government Sponsored Enterprise (GSE). We are federally chartered under the Farm Credit Act of 1971, as amended (the Farm Credit Act).

We are cooperatively owned by our U.S. customers, which consist of agricultural cooperatives, rural energy, communications and water companies, farmer-owned financial institutions, including Agricultural Credit Associations (Associations) and other businesses that serve vital industries in rural America.

Our wholly-owned leasing subsidiary, Farm Credit Leasing Services Corporation (FCL), specializes in lease financing and related services for a broad range of equipment, machinery, vehicles and facilities.

In conjunction with other System entities, the Bank jointly owns the following service organizations, which were created to provide a variety of services for the System:

- (1) Federal Farm Credit Banks Funding Corporation (Funding Corporation), which issues, markets and processes Systemwide Debt Securities using a selling group, and also provides financial management and reporting services for the combined entities of the System;
- (2) FCS Building Association, which leases premises and equipment to the Farm Credit Administration (FCA), the System's regulator, as required by the Farm Credit Act; and
- (3) Farm Credit System Association Captive Insurance Company, a reciprocal insurer that provides insurance services such as directors and officers liability, fiduciary liability and a bankers bond to System organizations.

We have a minority ownership interest in Farm Credit Financial Partners, Inc., chartered under the Farm Credit Act as a service organization providing a range of support and technology services to certain System Associations. Additionally, we have a small equity interest in other System banks as required in connection with the purchase and sale of participation loans.

Copies of CoBank's financial reports are available on request by calling or visiting one of our banking center locations and through our website at www.cobank.com. Copies of financial reports of our affiliated Associations and the System are available on their respective websites.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

The consolidated financial statements include the accounts of CoBank and FCL after elimination of all significant intercompany accounts and transactions.

The accompanying consolidated financial statements exclude financial information of Northwest Farm Credit Services, ACA (Northwest) as well as the System Associations in the northeastern region of the United States (Northeast Associations), which are collectively referred to as our affiliated Associations. CoBank and our affiliated Associations are collectively referred to as the "District." Note 17 contains additional information about our affiliated Associations, and the supplemental information on pages 100 to 103 includes certain unaudited combined financial information of our affiliated Associations and the District.

We prepare our financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the financial services industry. These principles require us to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results may differ from those estimates. Significant estimates are discussed in these notes to the consolidated financial statements, as applicable. Certain reclassifications have been made to amounts reported in previous years to conform to the 2010 presentation.

Loans

We report loans, excluding leases, at their principal amount outstanding and accrue interest income based upon the daily principal amount outstanding. For loans purchased at a discount, we amortize unearned income using the straight-line method, which approximates the interest method.

We defer loan origination fees and costs, and amortize them over the life of the related loan as an adjustment to yield.

Except as otherwise noted, leases are included with loans in the consolidated financial statements and related notes. We record leases primarily as either direct financing or operating leases. Under direct financing leases, unearned finance income from lease contracts represents the excess of gross lease receivables over the cost of leased equipment, net of estimated residual values. Residual values, which are reviewed at least annually, represent the estimated amount to be received at lease termination from the disposition of leased assets. We amortize net unearned finance income to interest income using the interest method. Under operating leases, property is recorded at cost and depreciated on a straight-line basis over the lease term to an estimated residual or salvage value. We recognize revenue as earned ratably over the term of the operating lease.

Impaired Loans

Impaired loans are loans for which it is probable that not all principal and interest will be collected according to the contractual terms of the loans. Impaired loans include loans that are in nonaccrual status, restructured, or past due 90 days or more and still accruing interest.

We do not accrue interest income on impaired loans unless they are adequately secured and in the process of collection. When interest accruals are suspended, accrued and unpaid interest income is reversed with current year accruals charged to earnings and prior-year amounts charged off against the allowance for loan losses.

For nonaccrual loans, we primarily apply cash receipts against the outstanding principal balance. If collectibility of the loan balance is fully expected and certain other criteria are met, we recognize interest payments as interest income. We may return such loans to accrual status when the borrower is current, has demonstrated payment performance, collection of future payments is fully expected and there are no unrecovered charge-offs.

Accruing restructured loans are those for which the contractual terms and conditions have been amended or otherwise revised to incorporate certain monetary concessions made to the borrower that would not otherwise be made if not for economic or legal reasons. We place the loan in nonaccrual status if the borrower's ability to meet the revised contractual terms is uncertain.

We establish an impairment reserve if the fair value of assets held for operating leases decreases to below book value and such difference is not recoverable.

Allowance for Loan Losses and Reserve for Unfunded Commitments

Our allowance for loan losses reflects an adjustment to the value of our total loan and finance lease portfolio for inherent credit losses. We also maintain a separate reserve for unfunded commitments, which is reported as a liability on the Bank's consolidated balance sheet. We refer to the combined amounts of the allowance for loan losses and the reserve for unfunded commitments as the "reserve for credit exposure."

The reserve for credit exposure is maintained at a level we consider sufficient to absorb losses inherent in the loan and finance lease portfolio and in unfunded commitments. We base the reserve for credit exposure on our regular evaluation of these portfolios.

To determine our reserve for credit exposure, we divide our loans and finance leases into two broad categories: those that are impaired and those that are not. A loan or finance lease is impaired when, based on current information and events, it is probable that we will not collect all amounts due under the contractual terms. Impairment of loans and finance leases is measured based on the fair value of the collateral, if the loan or finance lease is collateral dependent, or the present value of expected future cash flows discounted at the effective interest rate of the contract. In limited cases, we base the impairment on observable market prices. Changes in the financial condition of our borrowers and in the general economy will cause these estimates, appraisals and evaluations to change.

For loans and finance leases that are not individually assessed for impairment, we establish a reserve for credit exposure for losses that are both probable and estimable as of the balance sheet date. The evaluation of this portion of our portfolio generally considers default rates from industry data, internal risk ratings, loss given default assumptions, historical recovery rates, specific industry conditions, general economic and political conditions, and changes in the character, composition and performance of the portfolio, among other factors. We also consider overall portfolio indicators, including trends in internally risk-rated exposures, classified exposures, and historical write-offs and recoveries. Additionally, we review industry, geographic and portfolio concentrations, including current developments within operating segments. Changes in these factors, or our assumptions and estimates thereof, could result in a change in the reserve and could have a direct and material impact on the provision for loan losses and our results of operations. The total reserve for credit exposure is available to absorb probable and estimable credit losses within our entire portfolio.

We increase or decrease the reserve for credit exposure by recording a provision or reversal for loan losses in the income statement. We record loan losses against the allowance for loan losses when management determines that any portion of the loan or finance lease is uncollectible. We add subsequent recoveries, if any, to the allowance for loan losses. Transfers between the allowance for loan losses and the reserve for unfunded commitments can occur in conjunction with funding a loan and thereby decreasing unfunded commitments or, conversely, repaying a loan and thereby increasing unfunded commitments. Newly-executed loan commitments will also increase this liability.

We also assess the credit risk associated with off-balance sheet loan commitments and letters of credit and determine the appropriate level of reserve for unfunded commitments that should be recorded.

We refined our methodology for determining the allowance for loan losses in 2008. Our revised methodology focuses on more closely aligning the allowance process with our economic capital process while ensuring there remains a high level of correlation between the allowance and the risk profile of the Bank's loan and finance lease portfolio. The refined methodology also takes into consideration potential losses related to unfunded commitments. While the refinement did not change our overall reserve levels, it did result in a reclassification of \$154.2 million in 2008 from the allowance for loan losses to the reserve for unfunded commitments on the Bank's consolidated balance sheet and a reallocation of a portion of our loan loss reserves among our operating segments.

Effective December 31, 2010, we adopted provisions recently issued by the Financial Accounting Standards Board (FASB) which provide for enhanced disclosures related to loan quality and our reserve for credit exposure. See Note 3 for a description of these provisions and related disclosures.

Cash

For purposes of these financial statements, cash represents deposits at banks and cash on hand which are used for operating or liquidity purposes.

Investment Securities

We classify investment securities as available-for-sale and report them at their estimated fair value. We have no trading or held-to-maturity securities. We amortize or accrete purchased premiums and discounts using the constant yield method, which approximates the interest method, over the terms of the respective securities. We report unrealized gains and losses, net of applicable income taxes and credit losses, in the accumulated other comprehensive income (loss) component of shareholders' equity on the consolidated balance sheets. We use the specific identification method for determining cost in computing realized gains and losses on sales of investment securities.

We evaluate investments in a loss position to determine if such a loss is other-than-temporary. If losses are deemed to be other-than-temporary, we record the portion related to credit losses in earnings and the portion related to all other factors in other comprehensive income (loss). For additional information, refer to Note 4.

Premises and Equipment

We carry premises and equipment at cost less accumulated depreciation and amortization. We provide for depreciation and amortization on the straight-line method over the estimated useful lives of the assets. We record gains and losses on dispositions in current operating results. We record maintenance and repairs to operating expenses when incurred and capitalize improvements.

We capitalize leased property and equipment meeting certain criteria and depreciate such assets using the straight-line method over the terms of the respective leases.

Derivative Financial Instruments and Hedging Activities

We record derivatives as assets or liabilities at their fair value on the consolidated balance sheets. We record changes in the fair value of a derivative in current period earnings or accumulated other comprehensive income (loss), depending on the use of the derivative and whether it qualifies for fair value or cash flow hedge accounting. For derivatives not designated as hedging instruments, we record the related change in fair value in current period earnings.

We formally document all relationships between derivatives and hedged items, as well as risk management objectives and strategies for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair value or cash flow hedges to assets and liabilities on the consolidated balance sheets or to forecasted transactions.

We also formally assess (both at the hedge's inception and on an ongoing basis) whether the derivatives that are used in hedging transactions have been effective in offsetting changes in the fair value or cash flows of hedged items and whether those derivatives are expected to remain effective in future periods. We typically use regression analyses or other statistical analyses to assess the effectiveness of hedges. Hedge accounting is discontinued prospectively if: (i) it is determined that the derivative is no longer effective in offsetting changes in the fair value or cash flows of a hedged item; (ii) the derivative expires or is sold, terminated or exercised; or (iii) management determines that the fair value or cash flow hedge designation is no longer appropriate.

If we determine that a derivative no longer qualifies as an effective fair value or cash flow hedge, or if management removes the hedge designation, we continue to carry the derivative on the balance sheet at fair value, with changes in fair value recognized in current period earnings as part of noninterest income. For discontinued cash flow hedges, we amortize the component of other comprehensive income (loss) to net interest income over the original term of the hedge contract. For additional information, refer to Note 11.

Fair Value Measurements

Our fair value measurements represent the estimated amount to be received to sell an asset or paid to transfer or extinguish a liability (an exit price) in active markets among willing participants at the reporting date. We maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The classification of assets and liabilities measured at fair value within the disclosure hierarchy is based on the three levels of inputs to the fair value measurement process. For additional information, refer to Note 12.

Fair Value of Guarantor's Obligations

We provide standby letters of credit, which are irrevocable undertakings to guarantee payment of a specified financial obligation. As a guarantor, we recognize a liability for the fair value of the obligation undertaken in issuing the guarantee. Our liability for the fair value of these obligations is determined by applying a risk-adjusted spread percentage to those obligations.

Employee Benefit Plans

Our employee benefit plans are described in Note 8. The net expense for employee benefit plans is recorded as employee compensation expense. For defined benefit pension plans, we use the "Projected Unit Credit" actuarial method for financial reporting and funding purposes.

The anticipated costs of benefits related to postretirement health care and life insurance are accrued during the period of the employees' active service and are classified as employee compensation expense.

Income Taxes

We operate as a nonexempt cooperative, which qualifies for tax treatment under Subchapter T of the Internal Revenue Code. Accordingly, amounts distributed as qualified patronage distributions to borrowers in the form of cash or stock may be deducted from taxable income. We base provisions for income taxes for financial reporting purposes only on those taxable earnings that will not be distributed as qualified patronage distributions.

We record deferred tax assets and liabilities for temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. We measure these deferred amounts using the current marginal statutory tax rate. Calculating deferred tax assets and liabilities involves various management estimates and assumptions as to future taxable earnings. We expect to fully realize deferred tax assets based on the projected level of future taxable income.

See Note 9 for further information regarding income taxes.

Subsequent Events

We have evaluated subsequent events through March 1, 2011, which is the date the financial statements were issued.

Note 3 – Loans, Loan Quality and Reserve for Credit Exposure

Loans Outstanding

Loans outstanding by type are shown below.

(\$ in Millions)

| December 31, | 2010 | | 2009 | | 2008 | |
|-------------------------|------------------|--------------|------------------|--------------|------------------|--------------|
| | Amount | % | Amount | % | Amount | % |
| Agribusiness | \$ 22,676 | 45 % | \$ 17,469 | 39 % | \$ 18,498 | 42 % |
| Strategic Relationships | 15,392 | 31 | 15,271 | 35 | 15,026 | 33 |
| Rural Infrastructure | 11,924 | 24 | 11,434 | 26 | 11,026 | 25 |
| Total | \$ 49,992 | 100 % | \$ 44,174 | 100 % | \$ 44,550 | 100 % |
| Loans Purchased | \$ 8,403 | | \$ 8,650 | | \$ 8,320 | |
| Loans Sold | 8,291 | | 6,859 | | 7,305 | |

Loans are outstanding in all 50 states as well as 32 foreign countries and a limited number of U.S. territories.

Our international loan portfolio, included in our Agribusiness segment, reflects significant concentration in U.S. government-sponsored trade financing programs which guarantee payment in the event of default by the borrower of generally 98 percent of loan principal outstanding and varying percentages of interest due. Of the \$4.0 billion in international loans outstanding as of December 31, 2010, 87 percent were guaranteed by the U.S. government under one of these trade financing programs, primarily the General Sales Manager (GSM) program of the U.S. Department of Agriculture's Commodity Credit Corporation.

We make loans to customers in various industries. Industries that represent 10 percent or more of total loans outstanding for any of the periods presented below are as follows:

| December 31, | 2010 | 2009 | 2008 |
|--|------|------|------|
| Farm Supply, Grain and Marketing | 22 % | 13 % | 14 % |
| Energy | 17 | 18 | 16 |
| Commodities (Other than Fruits, Nuts and Vegetables) | 8 | 9 | 10 |

Reserve for Credit Exposure

The following tables present the changes in the components of our reserve for credit exposure and the details of the ending balances. The reserve for credit exposure includes the allowance for loan losses and the reserve for unfunded commitments. The elements of our reserve for credit exposure are presented by operating segment.

Loans to our affiliated Associations represented 23 percent, 25 percent, and 24 percent of total loans outstanding at December 31, 2010, 2009 and 2008, respectively. Together, our affiliated Associations provide financing and other financial services to approximately 28,000 farmer-owners for rural real estate, equipment, working capital, agricultural production and operating purposes in geographic regions in the northwestern and northeastern United States. Participations in loans made by other System banks to their affiliated Associations represented 8 percent, 9 percent, and 9 percent of our total loans outstanding at December 31, 2010, 2009 and 2008, respectively.

Unamortized loan premiums and discounts, and unamortized deferred loan fees and costs totaled \$69.0 million, \$70.7 million and \$65.3 million as of December 31, 2010, 2009 and 2008, respectively.

As discussed in Note 2, we adopted provisions issued by the FASB which expanded the disclosures related to loan quality and the reserve for credit exposure effective December 31, 2010. The following provides details of the expanded disclosures.

| | Strategic | | Rural | | |
|---|----------------------|------------------------------|----------------------|-----------|----------------------|
| | Agribusiness | Relationships ⁽¹⁾ | Infrastructure | | Total |
| December 31, 2010 | | | | | |
| Allowance for Loan Losses | | | | | |
| Beginning Balance | \$ 264,540 | \$ - | \$ 105,277 | \$ | \$ 369,817 |
| Charge-offs | (25,893) | - | (50,502) | | (76,395) |
| Recoveries | 4,234 | - | 14,514 | | 18,748 |
| Provision for Loan Losses | 7,167 | - | 52,833 | | 60,000 |
| Transfers from (to) Reserve for Unfunded Commitments | 34,169 | - | (5,595) | | 28,574 |
| Ending Balance | 284,217 | - | 116,527 | | 400,744 |
| Reserve for Unfunded Commitments | | | | | |
| Beginning Balance | 102,768 | - | 25,605 | | 128,373 |
| Transfers from (to) Allowance for Loan Losses | (34,169) | - | 5,595 | | (28,574) |
| Ending Balance | 68,599 | - | 31,200 | | 99,799 |
| Reserve for Credit Exposure | \$ 352,816 | \$ - | \$ 147,727 | \$ | \$ 500,543 |
| Reserve for Credit Exposure | | | | | |
| Ending Balance, Reserve for Credit Exposure Related to Loans: | | | | | |
| Individually Evaluated for Impairment | \$ 16,918 | \$ - | \$ 23,200 | \$ | \$ 40,118 |
| Collectively Evaluated for Impairment | 335,898 | - | 124,527 | | 460,425 |
| Acquired with Deteriorated Credit Quality | - | - | - | | - |
| Total | \$ 352,816 | \$ - | \$ 147,727 | \$ | \$ 500,543 |
| Loans | | | | | |
| Ending Balance for Loans and Related Accrued Interest: | | | | | |
| Individually Evaluated for Impairment | \$ 93,373 | \$ 15,435,194 | \$ 73,600 | \$ | \$ 15,602,167 |
| Collectively Evaluated for Impairment | 22,644,294 | - | 11,917,340 | | 34,561,634 |
| Acquired with Deteriorated Credit Quality | - | - | - | | - |
| Total | \$ 22,737,667 | \$ 15,435,194 | \$ 11,990,940 | \$ | \$ 50,163,801 |
| December 31, 2009 | | | | | |
| Allowance for Loan Losses | | | | | |
| Beginning Balance | \$ 230,995 | \$ - | \$ 98,203 | \$ | \$ 329,198 |
| Charge-offs | (36,958) | - | (33,240) | | (70,198) |
| Recoveries | 4,850 | - | 117 | | 4,967 |
| Provision for Loan Losses | 39,000 | - | 41,000 | | 80,000 |
| Transfers from (to) Reserve for Unfunded Commitments | 26,653 | - | (803) | | 25,850 |
| Ending Balance | 264,540 | - | 105,277 | | 369,817 |
| Reserve for Unfunded Commitments | | | | | |
| Beginning Balance | 129,421 | - | 24,802 | | 154,223 |
| Transfers from (to) Allowance for Loan Losses | (26,653) | - | 803 | | (25,850) |
| Ending Balance | 102,768 | - | 25,605 | | 128,373 |
| Reserve for Credit Exposure | \$ 367,308 | \$ - | \$ 130,882 | \$ | \$ 498,190 |
| Reserve for Credit Exposure | | | | | |
| Ending Balance, Reserve for Credit Exposure Related to Loans: | | | | | |
| Individually Evaluated for Impairment | \$ 38,760 | \$ - | \$ 27,052 | \$ | \$ 65,812 |
| Collectively Evaluated for Impairment | 328,548 | - | 103,830 | | 432,378 |
| Acquired with Deteriorated Credit Quality | - | - | - | | - |
| Total | \$ 367,308 | \$ - | \$ 130,882 | \$ | \$ 498,190 |
| Loans | | | | | |
| Ending Balance for Loans and Related Accrued Interest: | | | | | |
| Individually Evaluated for Impairment | \$ 209,141 | \$ 15,319,728 | \$ 98,489 | \$ | \$ 15,627,358 |
| Collectively Evaluated for Impairment | 17,303,598 | - | 11,400,984 | | 28,704,582 |
| Acquired with Deteriorated Credit Quality | - | - | - | | - |
| Total | \$ 17,512,739 | \$ 15,319,728 | \$ 11,499,473 | \$ | \$ 44,331,940 |

| | Agribusiness | Strategic Relationships ⁽¹⁾ | Rural Infrastructure | Total |
|---|---------------|--|----------------------|---------------|
| December 31, 2008 | | | | |
| Allowance for Loan Losses | | | | |
| Beginning Balance | \$ 304,074 | \$ - | \$ 143,152 | \$ 447,226 |
| Charge-offs | (17,574) | - | (8,000) | (25,574) |
| Recoveries | 3,916 | - | 2,853 | 6,769 |
| Provision (Reversal) for Loan Losses | 70,000 | - | (15,000) | 55,000 |
| Transfers to Reserve for Unfunded Commitments | (129,421) | - | (24,802) | (154,223) |
| Ending Balance | 230,995 | - | 98,203 | 329,198 |
| Reserve for Unfunded Commitments | | | | |
| Beginning Balance | - | - | - | - |
| Transfers from Allowance for Loan Losses | 129,421 | - | 24,802 | 154,223 |
| Ending Balance | 129,421 | - | 24,802 | 154,223 |
| Reserve for Credit Exposure | \$ 360,416 | \$ - | \$ 123,005 | \$ 483,421 |
| Reserve for Credit Exposure | | | | |
| Ending Balance, Reserve for Credit Exposure Related to Loans: | | | | |
| Individually Evaluated for Impairment | \$ 21,337 | \$ - | \$ 4,000 | \$ 25,337 |
| Collectively Evaluated for Impairment | 339,079 | - | 119,005 | 458,084 |
| Acquired with Deteriorated Credit Quality | - | - | - | - |
| Total | \$ 360,416 | \$ - | \$ 123,005 | \$ 483,421 |
| Loans | | | | |
| Ending Balance for Loans and Related Accrued Interest: | | | | |
| Individually Evaluated for Impairment | \$ 193,067 | \$ 15,102,755 | \$ 24,730 | \$ 15,320,552 |
| Collectively Evaluated for Impairment | 18,375,371 | - | 11,072,013 | 29,447,384 |
| Acquired with Deteriorated Credit Quality | - | - | - | - |
| Total | \$ 18,568,438 | \$ 15,102,755 | \$ 11,096,743 | \$ 44,767,936 |

⁽¹⁾ As a result of our strong collateral position with respect to loans to Associations, along with the earnings, capital and loss reserves of Associations that serve as an additional layer of protection against losses, no reserve for credit exposure is recorded in our Strategic Relationships operating segment.

The information in the tables under the Credit Quality, Aging Analysis and Impaired Loans captions is presented by operating segment, with guaranteed and non-guaranteed loans in our Agribusiness segment separately identified.

Credit Quality

The following table presents our loans and related accrued interest by credit quality classification pursuant to our regulator's Uniform Loan Classification System.

| | Agribusiness | | Agribusiness | | Strategic | | Rural | | |
|--------------------------|----------------|-------------------|--------------|------------------|---------------|-------------------|----------------|-------------------|----------------------|
| December 31, 2010 | Non-Guaranteed | | Guaranteed | | Relationships | | Infrastructure | | Total |
| Acceptable | \$ | 17,577,545 | \$ | 3,385,473 | \$ | 14,885,307 | \$ | 11,688,197 | \$ 47,536,522 |
| Special Mention | | 1,192,436 | | 208 | | 399,787 | | 177,407 | 1,769,838 |
| Substandard | | 564,926 | | 266 | | 150,100 | | 99,416 | 814,708 |
| Doubtful | | 16,813 | | - | | - | | 25,920 | 42,733 |
| Loss | | - | | - | | - | | - | - |
| Total | \$ | 19,351,720 | \$ | 3,385,947 | \$ | 15,435,194 | \$ | 11,990,940 | \$ 50,163,801 |
| December 31, 2009 | | | | | | | | | |
| Acceptable | \$ | 12,278,589 | \$ | 3,595,914 | \$ | 15,319,728 | \$ | 11,290,307 | \$ 42,484,538 |
| Special Mention | | 787,302 | | - | | - | | 98,540 | 885,842 |
| Substandard | | 811,229 | | - | | - | | 83,574 | 894,803 |
| Doubtful | | 39,705 | | - | | - | | 27,052 | 66,757 |
| Loss | | - | | - | | - | | - | - |
| Total | \$ | 13,916,825 | \$ | 3,595,914 | \$ | 15,319,728 | \$ | 11,499,473 | \$ 44,331,940 |
| December 31, 2008 | | | | | | | | | |
| Acceptable | \$ | 14,219,168 | \$ | 3,242,363 | \$ | 15,102,755 | \$ | 10,951,014 | \$ 43,515,300 |
| Special Mention | | 479,691 | | - | | - | | 73,308 | 552,999 |
| Substandard | | 600,878 | | - | | - | | 68,421 | 669,299 |
| Doubtful | | 26,338 | | - | | - | | 4,000 | 30,338 |
| Loss | | - | | - | | - | | - | - |
| Total | \$ | 15,326,075 | \$ | 3,242,363 | \$ | 15,102,755 | \$ | 11,096,743 | \$ 44,767,936 |

Aging Analysis

The following tables present an aging of past due loans and related accrued interest.

| | Agribusiness | | Agribusiness | | Strategic | | Rural | | |
|--|----------------|-------------------|--------------|------------------|---------------|-------------------|----------------|-------------------|----------------------|
| December 31, 2010 | Non-Guaranteed | | Guaranteed | | Relationships | | Infrastructure | | Total |
| 30-89 Days Past Due | \$ | 8,606 | \$ | - | \$ | - | \$ | - | \$ 8,606 |
| 90 Days Past Due | | 5,664 | | - | | - | | 33,716 | 39,380 |
| Total Past Due | \$ | 14,270 | \$ | - | \$ | - | \$ | 33,716 | \$ 47,986 |
| Current | | 19,337,450 | | 3,385,947 | | 15,435,194 | | 11,957,224 | 50,115,815 |
| Total Loans Outstanding | \$ | 19,351,720 | \$ | 3,385,947 | \$ | 15,435,194 | \$ | 11,990,940 | \$ 50,163,801 |
| Accruing Loans 90 Days or More Past Due | | | | | | | | | |
| | \$ | 681 | \$ | - | \$ | - | \$ | - | \$ 681 |
| December 31, 2009 | | | | | | | | | |
| 30-89 Days Past Due | \$ | 42,368 | \$ | - | \$ | - | \$ | 14,602 | \$ 56,970 |
| 90 Days Past Due | | 35,219 | | - | | - | | 86,118 | 121,337 |
| Total Past Due | \$ | 77,587 | \$ | - | \$ | - | \$ | 100,720 | \$ 178,307 |
| Current | | 13,839,238 | | 3,595,914 | | 15,319,728 | | 11,398,753 | 44,153,633 |
| Total Loans Outstanding | \$ | 13,916,825 | \$ | 3,595,914 | \$ | 15,319,728 | \$ | 11,499,473 | \$ 44,331,940 |
| Accruing Loans 90 Days or More Past Due | | | | | | | | | |
| | \$ | 13,138 | \$ | - | \$ | - | \$ | 2,097 | \$ 15,235 |

| December 31, 2008 | Agribusiness Non-Guaranteed | Agribusiness Guaranteed | Strategic Relationships | Rural Infrastructure | Total |
|--|--------------------------------|----------------------------|----------------------------|-------------------------|----------------------|
| 30-89 Days Past Due | \$ 31,547 | \$ - | \$ - | \$ 1,217 | \$ 32,764 |
| 90 Days Past Due | 12,698 | - | - | 2 | 12,700 |
| Total Past Due | \$ 44,245 | \$ - | \$ - | \$ 1,219 | \$ 45,464 |
| Current | 15,281,830 | 3,242,363 | 15,102,755 | 11,095,524 | 44,722,472 |
| Total Loans Outstanding | \$ 15,326,075 | \$ 3,242,363 | \$ 15,102,755 | \$ 11,096,743 | \$ 44,767,936 |
| Accruing Loans 90 Days or More Past Due | \$ 3,843 | \$ - | \$ - | \$ 1 | \$ 3,844 |

Impaired Loans

Impaired loan information is shown in the following tables. Loans past due 90 days or more and still accruing interest are adequately secured and in the process of collection.

| December 31, 2010 | Agribusiness Non-Guaranteed | Agribusiness Guaranteed ⁽¹⁾ | Strategic Relationships ⁽¹⁾ | Rural Infrastructure | Total |
|--|--------------------------------|---|---|-------------------------|-------------------|
| Nonaccrual Loans | \$ 93,373 | \$ - | \$ - | \$ 73,600 | \$ 166,973 |
| Accruing Loans 90 Days or More Past Due | 681 | - | - | - | 681 |
| Restructured Loans | - | - | - | - | - |
| Total Impaired Loans | \$ 94,054 | \$ - | \$ - | \$ 73,600 | \$ 167,654 |
| December 31, 2009 | | | | | |
| Nonaccrual Loans | \$ 209,141 | \$ - | \$ - | \$ 98,489 | \$ 307,630 |
| Accruing Loans 90 Days or More Past Due | 13,138 | - | - | 2,097 | 15,235 |
| Restructured Loans | - | - | - | - | - |
| Total Impaired Loans | \$ 222,279 | \$ - | \$ - | \$ 100,586 | \$ 322,865 |
| December 31, 2008 | | | | | |
| Nonaccrual Loans | \$ 193,067 | \$ - | \$ - | \$ 24,730 | \$ 217,797 |
| Accruing Loans 90 Days or More Past Due | 3,843 | - | - | 1 | 3,844 |
| Restructured Loans | 160 | - | - | - | 160 |
| Total Impaired Loans | \$ 197,070 | \$ - | \$ - | \$ 24,731 | \$ 221,801 |

⁽¹⁾ There were no impaired loans in our Agribusiness Guaranteed or Strategic Relationships portfolios for any of the periods presented.

Nonaccrual loans at December 31, 2010 do not include \$52.9 million in loans to a foreign bank due to the existence of U.S. government guarantees on a significant portion of such loans. For the year ended December 31, 2010, we charged off the unguaranteed portion of these loans totaling \$2.4 million, while the remaining \$50.5 million of the loans were performing according to the contractual U.S. government guarantees and remained in accruing status.

The following tables present information on impaired loans and related amounts in the allowance for loan losses.

| December 31, 2010 | Agribusiness Non-Guaranteed | Agribusiness Guaranteed ⁽¹⁾ | Strategic Relationships ⁽¹⁾ | Rural Infrastructure | Total |
|---|--------------------------------|---|---|-------------------------|------------|
| Impaired Loans With No Related Allowance for Loan Losses | | | | | |
| Carrying Amount | \$ 34,866 | \$ - | \$ - | \$ 20,952 | \$ 55,818 |
| Unpaid Principal | 47,004 | - | - | 39,939 | 86,943 |
| Average Balance | 106,480 | - | - | 28,357 | 134,837 |
| Interest Income Recognized | 4,405 | - | - | 1,059 | 5,464 |
| Impaired Loans With Related Allowance for Loan Losses | | | | | |
| Carrying Amount | 59,188 | - | - | 52,648 | 111,836 |
| Unpaid Principal | 76,519 | - | - | 65,223 | 141,742 |
| Allowance for Loan Losses | 16,918 | - | - | 23,200 | 40,118 |
| Average Balance | 65,001 | - | - | 61,777 | 126,778 |
| Interest Income Recognized | - | - | - | - | - |
| Total Impaired Loans | | | | | |
| Carrying Amount | 94,054 | - | - | 73,600 | 167,654 |
| Unpaid Principal | 123,523 | - | - | 105,162 | 228,685 |
| Allowance for Loan Losses | 16,918 | - | - | 23,200 | 40,118 |
| Average Balance | 171,481 | - | - | 90,134 | 261,615 |
| Interest Income Recognized | 4,405 | - | - | 1,059 | 5,464 |
| December 31, 2009 | | | | | |
| Impaired Loans With No Related Allowance for Loan Losses | | | | | |
| Carrying Amount | \$ 80,118 | \$ - | \$ - | \$ 24,406 | \$ 104,524 |
| Unpaid Principal | 98,141 | - | - | 63,325 | 161,466 |
| Average Balance | 40,461 | - | - | 30,391 | 70,852 |
| Interest Income Recognized | 3,953 | - | - | 298 | 4,251 |
| Impaired Loans With Related Allowance for Loan Losses | | | | | |
| Carrying Amount | 142,161 | - | - | 76,180 | 218,341 |
| Unpaid Principal | 154,354 | - | - | 95,267 | 249,621 |
| Allowance for Loan Losses | 38,760 | - | - | 27,052 | 65,812 |
| Average Balance | 166,189 | - | - | 88,922 | 255,111 |
| Interest Income Recognized | 2,154 | - | - | 3,184 | 5,338 |
| Total Impaired Loans | | | | | |
| Carrying Amount | 222,279 | - | - | 100,586 | 322,865 |
| Unpaid Principal | 252,495 | - | - | 158,592 | 411,087 |
| Allowance for Loan Losses | 38,760 | - | - | 27,052 | 65,812 |
| Average Balance | 206,650 | - | - | 119,313 | 325,963 |
| Interest Income Recognized | 6,107 | - | - | 3,482 | 9,589 |

| December 31, 2008 | Agribusiness Non-Guaranteed | Agribusiness Guaranteed ⁽¹⁾ | Strategic Relationships ⁽¹⁾ | Rural Infrastructure | Total |
|---|--------------------------------|---|---|-------------------------|------------|
| Impaired Loans With No Related Allowance for Loan Losses | | | | | |
| Carrying Amount | \$ 126,709 | \$ - | \$ - | \$ 6,361 | \$ 133,070 |
| Unpaid Principal | 134,005 | - | - | 30,034 | 164,039 |
| Average Balance | 41,096 | - | - | 1,272 | 42,368 |
| Interest Income Recognized | 4,464 | - | - | 1,252 | 5,716 |
| Impaired Loans With Related Allowance for Loan Losses | | | | | |
| Carrying Amount | 70,361 | - | - | 18,370 | 88,731 |
| Unpaid Principal | 86,867 | - | - | 26,837 | 113,704 |
| Allowance for Loan Losses | 21,337 | - | - | 4,000 | 25,337 |
| Average Balance | 49,066 | - | - | 3,674 | 52,740 |
| Interest Income Recognized | 2,551 | - | - | 1,144 | 3,695 |
| Total Impaired Loans | | | | | |
| Carrying Amount | 197,070 | - | - | 24,731 | 221,801 |
| Unpaid Principal | 220,872 | - | - | 56,871 | 277,743 |
| Allowance for Loan Losses | 21,337 | - | - | 4,000 | 25,337 |
| Average Balance | 90,162 | - | - | 4,946 | 95,108 |
| Interest Income Recognized | 7,015 | - | - | 2,396 | 9,411 |

⁽¹⁾ There were no impaired loans in our Agribusiness Guaranteed or Strategic Relationships portfolios for any of the periods presented.

Interest income forgone on nonaccrual and accruing restructured loans is as follows:

| Year Ended December 31, 2010 | |
|---|------------------|
| Interest Income Which Would Have Been Recognized Per Original Terms | \$ 20,619 |
| Less: Interest Income Recognized | (5,464) |
| Forgone Interest Income | \$ 15,155 |

Commitments on Impaired Loans

There were \$32.0 million in commitments to extend additional credit to borrowers whose loans were classified as impaired at December 31, 2010.

Leases Outstanding

A summary of the components of FCL's net investment in direct financing leases and property on operating leases is as follows:

| (\$ in Millions) | December 31, | 2010 | 2009 | 2008 |
|---|-----------------|-----------------|-----------------|------|
| Net Investment in Direct Financing Leases: | | | | |
| Minimum Lease Payments to be Received, | | | | |
| Net of Participation Interests | \$ 1,232 | \$ 1,342 | \$ 1,235 | |
| Estimated Residual Values of Leased | | | | |
| Property (Unguaranteed) | 311 | 296 | 287 | |
| Initial Direct Costs | 10 | 11 | 11 | |
| Less: Unearned Finance Income | (212) | (242) | (287) | |
| Net Investment in Direct Financing Leases | \$ 1,341 | \$ 1,407 | \$ 1,246 | |
| Property on Operating Leases: | | | | |
| Vehicles and Other Equipment | \$ 750 | \$ 750 | \$ 832 | |
| Initial Direct Costs | 2 | 2 | 2 | |
| Total | 752 | 752 | 834 | |
| Less: Accumulated Depreciation | (339) | (317) | (390) | |
| Net Property on Operating Leases | \$ 413 | \$ 435 | \$ 444 | |
| Year Ended December 31, | 2010 | 2009 | 2008 | |
| Depreciation Expense | \$ 123 | \$ 124 | \$ 113 | |

At December 31, 2010, gross minimum lease payments to be received for direct financing leases and minimum future rental revenue for noncancelable operating leases are as follows:

(\$ in Millions)

| Year | Minimum Lease Payments | Minimum Future Rental Revenue |
|------------------|------------------------|-------------------------------|
| 2011 | \$ 352 | \$ 103 |
| 2012 | 310 | 81 |
| 2013 | 209 | 48 |
| 2014 | 136 | 26 |
| 2015 | 80 | 11 |
| Subsequent Years | 145 | 11 |

Note 4 – Investment Securities

A summary of investment securities available-for-sale follows. See Note 12 for disclosures about estimated fair values of financial instruments, including investments.

(\$ in Millions)

| December 31, 2010 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|-------------------------------|------------------|------------------------|-------------------------|------------------|
| U.S. Treasury and Agency Debt | \$ 3,311 | \$ 47 | \$ - | \$ 3,358 |
| Mortgage-Backed: | | | | |
| U.S. Agency | 8,673 | 124 | (58) | 8,739 |
| Non-Agency | 424 | 2 | (24) | 402 |
| Asset-Backed | 143 | - | (25) | 118 |
| Total | \$ 12,551 | \$ 173 | \$ (107) | \$ 12,617 |

(\$ in Millions)

| December 31, 2009 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|-------------------------------|------------------|------------------------|-------------------------|------------------|
| U.S. Treasury and Agency Debt | \$ 3,314 | \$ 12 | \$ (5) | \$ 3,321 |
| Mortgage-Backed: | | | | |
| U.S. Agency | 7,616 | 150 | (26) | 7,740 |
| Non-Agency | 656 | - | (82) | 574 |
| Asset-Backed | 225 | - | (52) | 173 |
| Total | \$ 11,811 | \$ 162 | \$ (165) | \$ 11,808 |

(\$ in Millions)

| December 31, 2008 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|-------------------|------------------|------------------------|-------------------------|------------------|
| U.S. Agency Debt | \$ 1,500 | \$ 41 | \$ - | \$ 1,541 |
| Mortgage-Backed: | | | | |
| U.S. Agency | 8,908 | 92 | (132) | 8,868 |
| Non-Agency | 961 | - | (149) | 812 |
| Asset-Backed | 338 | 3 | (25) | 316 |
| Total | \$ 11,707 | \$ 136 | \$ (306) | \$ 11,537 |

A summary of the contractual maturity, amortized cost, fair value and weighted average yield of investment securities by type at December 31, 2010 is as follows:

U.S. Treasury and Agency Debt Securities

(\$ in Millions)

| | Amortized Cost | Fair Value | Weighted Average Yield |
|---------------------|-----------------|-----------------|------------------------|
| In One Year or Less | \$ 1,517 | \$ 1,522 | 0.72 % |
| One to Five Years | 1,294 | 1,298 | 0.64 |
| Five to Ten Years | 500 | 538 | 4.11 |
| After Ten Years | - | - | - |
| Total | \$ 3,311 | \$ 3,358 | 1.20 |

Mortgage-Backed Securities

(\$ in Millions)

| | Amortized Cost | Fair Value | Weighted Average Yield |
|---------------------|-----------------|-----------------|------------------------|
| In One Year or Less | \$ - | \$ - | - % |
| One to Five Years | 138 | 139 | 2.12 |
| Five to Ten Years | 653 | 669 | 3.17 |
| After Ten Years | 8,306 | 8,333 | 2.35 |
| Total | \$ 9,097 | \$ 9,141 | 2.41 |

Asset-Backed Securities

(\$ in Millions)

| | Amortized Cost | Fair Value | Weighted Average Yield |
|---------------------|----------------|---------------|------------------------|
| In One Year or Less | \$ - | \$ - | - % |
| One to Five Years | - | - | - |
| Five to Ten Years | - | - | - |
| After Ten Years | 143 | 118 | 4.54 |
| Total | \$ 143 | \$ 118 | 4.54 |

While the substantial majority of our mortgage-backed and asset-backed securities have contractual maturities in excess of 10 years, expected maturities for these securities will differ from contractual maturities because borrowers have the right to call or prepay obligations with or without penalties.

The following table shows the fair value and gross unrealized losses for investments in a loss position aggregated by investment category, and the length of time the securities have been in a continuous unrealized loss position. The continuous loss position is based on the date the impairment first occurred. Unrealized loss positions related to these securities, including those impaired for longer than 12 months, are primarily due to widened credit spreads and decreased liquidity in the broader financial markets.

| (\$ in Millions) | Less Than 12 Months | | Greater Than 12 Months | |
|-------------------------------|------------------------|-------------------|---------------------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| December 31, 2010 | | | | |
| U.S. Treasury and Agency Debt | \$ - | \$ - | \$ - | \$ - |
| Mortgage-Backed: | | | | |
| U.S. Agency | 3,188 | (56) | 641 | (2) |
| Non-Agency | - | - | 315 | (24) |
| Asset-Backed | - | - | 115 | (25) |
| Total | \$ 3,188 | \$ (56) | \$ 1,071 | \$ (51) |
| December 31, 2009 | | | | |
| U.S. Treasury and Agency Debt | \$ 1,303 | \$ (5) | \$ - | \$ - |
| Mortgage-Backed: | | | | |
| U.S. Agency | 329 | (2) | 2,537 | (24) |
| Non-Agency | 9 | - | 559 | (82) |
| Asset-Backed | - | - | 170 | (52) |
| Total | \$ 1,641 | \$ (7) | \$ 3,266 | \$ (158) |
| December 31, 2008 | | | | |
| U.S. Agency Debt | \$ - | \$ - | \$ - | \$ - |
| Mortgage-Backed: | | | | |
| U.S. Agency | 1,312 | (31) | 2,608 | (101) |
| Non-Agency | 442 | (90) | 358 | (59) |
| Asset-Backed | 84 | (3) | 176 | (22) |
| Total | \$ 1,838 | \$ (124) | \$ 3,142 | \$ (182) |

As of December 31, 2010, with the exception of the following securities, we expect to collect all principal and interest payments on our investment securities. We do not intend to sell the securities in unrealized loss positions, and it is not likely that we will be required to sell such securities, for regulatory, liquidity or other purposes, before a recovery of our cost basis occurs.

The following table summarizes other-than-temporary impairment (OTTI) losses recorded in earnings by security type.

| (\$ in Millions) | Number of Securities | OTTI | Fair Value |
|----------------------------|----------------------|---------------------|---------------|
| December 31, 2010 | | | |
| Asset-Backed | 7 | \$ 35 | \$ 110 |
| Non-Agency Mortgage-Backed | 3 | 9 | 74 |
| Total | 10 | \$ 44 | \$ 184 |
| December 31, 2009 | | | |
| Asset-Backed | 2 | \$ 11 | \$ 72 |
| Non-Agency Mortgage-Backed | 1 | 4 | 41 |
| Total | 3 | \$ 15 | \$ 113 |
| December 31, 2008 | | | |
| Asset-Backed | 1 | \$ 6 ⁽¹⁾ | \$ 6 |
| Non-Agency Mortgage-Backed | - | - | - |
| Total | 1 | \$ 6 | \$ 6 |

⁽¹⁾ During 2009, we sold this security for proceeds of \$3.4 million and recorded a gain on disposition of \$0.9 million

The following table details the activity related to the credit loss component of investment securities that have been written down for OTTI.

| Credit Losses on Impaired Investments | | (\$ in Millions) |
|---|--|------------------|
| Balance at December 31, 2009 | | \$ 15 |
| Additional Credit Impairments Related to Securities | | |
| Impaired as of December 31, 2009 | | 18 |
| Initial Credit Impairments Related to Securities | | |
| Not Previously Impaired | | 26 |
| Sales of Investments with Credit Impairments | | - |
| Subsequent Accretion for Increases in Cash Flows | | |
| Expected to be Collected | | - |
| Balance at December 31, 2010 | | \$ 59 |

For impaired investment securities, we estimate the component of unrealized losses attributable to credit losses using a third-party cash flow model. The model requires key assumptions related to underlying collateral, including the degree and timing of prepayments and defaults and loss severity. Assumptions used are influenced by such factors as interest rates and the performance, type and age of collateral. For prepayment assumptions, we use the lower of the three- or six-month historical voluntary prepayment rate. Prepayment rates used ranged from 3 percent to 17 percent for impaired investment securities at December 31, 2010. We apply historical performance information to estimate future defaults using a default timing curve. Lifetime default rates ranged from 14 percent to 45 percent for impaired investment securities at December 31, 2010. Loss severity assumptions are based on actual performance, where available, or are obtained from an independent third-party. Loss severity ranged from 29 percent to 100 percent for impaired investment securities at December 31, 2010.

Note 5 – Bonds and Notes

We are primarily liable for the following bonds and notes:

(\$ in Millions)

| December 31, | 2010 | 2009 | 2008 |
|------------------------------|------------------|------------------|------------------|
| Bonds | \$ 50,416 | \$ 48,035 | \$ 50,247 |
| Medium-term Notes | 376 | 499 | 625 |
| Discount Notes | 7,194 | 1,754 | 2,372 |
| Systemwide Debt Securities | 57,986 | 50,288 | 53,244 |
| Cash Investment | | | |
| Services Payable | 439 | 697 | 936 |
| Other | 899 | 926 | 1,185 |
| Total Bonds and Notes | \$ 59,324 | \$ 51,911 | \$ 55,365 |

The aggregate maturities and the weighted average interest rates of Systemwide Debt Securities at December 31, 2010 are shown in the accompanying table. Weighted average interest rates include the effect of related derivative financial instruments.

(\$ in Millions)

Maturities and Rates of Systemwide Debt Securities

| Year of Maturity | Bonds | | Medium-term Notes | | Discount Notes | | Total | |
|---------------------|------------------|--------------------------------|-------------------|--------------------------------|-----------------|--------------------------------|------------------|--------------------------------|
| | Amount | Weighted Average Interest Rate | Amount | Weighted Average Interest Rate | Amount | Weighted Average Interest Rate | Amount | Weighted Average Interest Rate |
| 2011 | \$ 13,714 | 0.65 % | \$ 26 | 6.54 % | \$ 7,194 | 0.25 % | \$ 20,934 | 0.52 % |
| 2012 | 14,821 | 0.52 | 26 | 2.27 | - | - | 14,847 | 0.52 |
| 2013 | 5,415 | 0.76 | 144 | 5.15 | - | - | 5,559 | 0.87 |
| 2014 | 3,340 | 1.64 | 10 | 8.16 | - | - | 3,350 | 1.66 |
| 2015 | 2,873 | 1.74 | 9 | 6.90 | - | - | 2,882 | 1.76 |
| 2016 and thereafter | 10,253 | 3.27 | 161 | 5.89 | - | - | 10,414 | 3.31 |
| Total | \$ 50,416 | 1.25 | \$ 376 | 5.46 | \$ 7,194 | 0.25 | \$ 57,986 | 1.15 |

Systemwide Debt Securities

We obtain funds for our lending activities and operations primarily from the sale of debt securities issued by System banks through the Funding Corporation. These debt securities are composed of bonds, medium-term notes and discount notes and are hereinafter referred to as Systemwide Debt Securities. Pursuant to the Farm Credit Act, Systemwide Debt Securities are the general unsecured joint and several obligations of the System banks. Systemwide Debt Securities are not obligations of, and are not guaranteed by, the U.S. government or any agency or instrumentality thereof, other than the System banks.

Bonds and medium-term notes are issued at fixed or floating interest rates with original maturities of up to 30 years. Bonds have original maturities of three months to 30 years. Medium-term notes have original maturities ranging from one to 30 years. Discount notes are issued with maturities ranging from one to 365 days. The weighted average remaining maturity of discount notes at December 31, 2010 was 143 days.

Cash investment services payable mature within one year. Other bonds and notes primarily represent cash collateral payable to derivative counterparties.

Certain Systemwide Debt Securities include debt which may be called on the first call date and, subsequently, called daily or on each interest payment date thereafter. At December 31, 2010, callable debt was \$3.2 billion, with the range of first call dates being from January 2011 through June 2015.

Conditions for Issuing Systemwide Debt

Certain conditions must be met before we can participate in the issuance of Systemwide Debt Securities. One such condition of participation, required by the Farm Credit Act and FCA regulations, is that we must maintain specified, eligible, unencumbered assets at least equal in value to the total amount of debt obligations outstanding for which we are primarily liable. Such assets exceeded applicable debt by \$5.4 billion at December 31, 2010. This requirement does not provide holders of Systemwide Debt Securities with a security interest in any of our assets.

In addition, because System banks are contingently liable for Systemwide Debt Securities of the other System banks, the banks have entered into agreements to provide for mutual protection. The System banks and the Funding Corporation operate under a Market Access Agreement (MAA) designed to address certain Funding Corporation statutory responsibilities. The MAA agreed-upon financial conditions establish mechanisms for monitoring, limiting and ultimately denying a troubled System bank's access to and participation in Systemwide debt issuances, thereby limiting other System banks' exposure to statutory joint and several liabilities. The MAA promotes the identification and resolution of financial problems of individual System banks in a timely manner. The System banks and the Funding Corporation have also entered into an Amended and Restated Contractual Interbank Performance Agreement (CIPA). The CIPA establishes an agreed-upon standard of financial condition and performance for the System banks and their affiliated Associations (the Districts). The CIPA measures various ratios taking into account the capital, asset quality, earnings, interest rate risk and liquidity of the Districts and System banks. In the event the banks do not meet the agreed-upon standards, the CIPA provides for certain intra-System bank economic incentives to be applied. At December 31, 2010, 2009 and 2008, all System banks, including CoBank, were in compliance with all of the conditions of participation for the issuance of Systemwide Debt Securities.

Insurance Fund

The Farm Credit Act established the Farm Credit System Insurance Corporation (Insurance Corporation) to administer the Farm Credit Insurance Fund (Insurance Fund). The Insurance Corporation insures the timely payment of principal and interest on Systemwide Debt Securities and carries out various other responsibilities.

The primary sources of funds for the Insurance Fund are premiums paid by the System banks and earnings on the Insurance Corporation assets. Premiums are determined and assessed to System banks semi-annually by the Insurance Corporation.

Each System bank is required to pay premiums into the Insurance Fund until the assets in the Insurance Fund reach the "secure base amount" (SBA), which is defined in the Farm Credit Act as 2 percent of the aggregate outstanding insured Systemwide Debt Securities (adjusted to reflect the reduced risk on loans or investments guaranteed by the U.S. or state governments) or such other percentage of the aggregate outstanding insured Systemwide Debt Securities as the Insurance Corporation in its sole discretion determines to be actuarially sound. When the amount in the Insurance Fund exceeds the SBA, the Insurance Corporation is required to reduce premiums, and, in some instances, may refund excess amounts, but must still ensure that premiums are sufficient to maintain the level of the Insurance Fund at the SBA.

The Insurance Fund ended 2009 above the SBA and, as a result, in 2010 the Insurance Corporation agreed to distribute to System banks the excess premium amounts generated in 2009, as well as excess premium amounts previously set aside in 2003. We recorded \$33.3 million in premium refunds from the Insurance Corporation that is classified in noninterest income in the consolidated income statement for the year ended December 31, 2010. We recorded no premium refunds from the Insurance Corporation in the years ended December 31, 2009 and 2008, respectively.

The Insurance Corporation premium rates were 5 basis points and 20 basis points of adjusted insured debt obligations for the years ended December 31, 2010 and 2009, respectively. The Insurance Corporation premium rates were 15 basis points of outstanding loan volume for the first half of 2008. Effective July 1, 2008, the premium base changed to average adjusted insured debt obligations, and the premium rates were 15 basis points and 18 basis points of adjusted insured debt obligations for the third and fourth quarters of 2008, respectively.

The Insurance Fund is available to assist with the timely payment of principal and interest on Systemwide Debt Securities, in the event of a default by a System bank, to the extent that net assets are available in the Insurance Fund. No other liabilities reflected in our financial statements are insured by the Insurance Corporation.

In addition, the Insurance Fund could be used to ensure the retirement of System entities' protected borrower equity at par or stated value and for other specified purposes. The Insurance Fund is also available for discretionary uses of providing assistance to certain troubled System institutions and to cover the operating expenses of the Insurance Corporation.

At December 31, 2010, the assets of the Insurance Fund aggregated \$3.2 billion. However, due to the other authorized uses of the Insurance Fund, there is no assurance that any available amount in the Insurance Fund will be sufficient to fund the timely payment of principal or interest on Systemwide Debt Securities in the event of a default by any System bank having primary liability thereon.

Early Extinguishments of Debt

During 2010, 2009 and 2008, we recorded losses of \$26.5 million, \$18.2 million and \$33.2 million, respectively, on the early extinguishments of \$235.7 million, \$231.2 million and \$1.7 billion, respectively, of Systemwide Debt Securities. These early extinguishments of debt resulted from our general practice of extinguishing higher cost, similarly tenored debt to offset the impact of prepayments in both our loan and investment portfolios and to maintain an appropriate mix of interest-earning assets and interest-bearing liabilities. All losses on early extinguishments of debt are reported as a component of noninterest income.

Note 6 – Subordinated Debt

At December 31, 2010, we had \$1.0 billion of subordinated debt outstanding, which is composed of two \$500 million issuances – one in April 2008 and the other in June 2007. The net proceeds of these issuances (\$993.5 million) were used to increase our regulatory permanent capital and total surplus, pursuant to FCA regulations, and for general corporate purposes. The subordinated debt is unsecured and subordinate to all other categories of creditors, including general creditors, and senior to all classes of shareholders.

The \$500 million of unsecured subordinated notes issued in April 2008 are due in 2018 and bear interest at a fixed rate of 7.875 percent, payable semi-annually in cash on the 15th day of April and October each year. Our \$500 million of unsecured subordinated notes issued in June 2007 are due in 2022 and bear interest at an annual rate equal to three-month USD LIBOR, reset quarterly, plus 0.60 percent, payable quarterly in cash on the 15th day of March, June, September and December each year. For both issuances, interest will be deferred if, as of the fifth business day prior to an interest payment date, any applicable minimum regulatory capital ratios are not satisfied. A deferral period may not last for more than the shorter of five consecutive years or the maturity date of the subordinated debt. Among certain other restrictions, we may not declare or pay any dividends or patronage distributions until interest payments are resumed and all deferred interest has been paid.

The 2007 issuance of subordinated debt may be redeemed, in whole or in part, at our option, on June 15, 2017, or in whole at our option at any time upon the occurrence of certain defined regulatory conditions, at a redemption price of 100 percent of the principal amount, plus any accrued but unpaid interest to the date of redemption, provided we have made payment in full of all amounts then due in respect of our senior indebtedness. The 2008 issuance may only be redeemed in whole at our option upon the occurrence of certain defined regulatory conditions.

Our subordinated debt is not considered System debt and is not an obligation of, or guaranteed by, the Farm Credit System or any banks in the System, other than CoBank. Payments on our subordinated debt are not insured by the Insurance Corporation.

Note 7 – Shareholders' Equity

Patronage

As a customer-owned bank, we return a portion of our earnings to shareholders in the form of qualified patronage distributions. Eligible shareholders will receive patronage for 2010 amounting to \$284.6 million, of which \$194.1 million will be paid in cash in 2011 and the balance will be paid in common stock. For 2009 and 2008, total patronage was \$268.9 million and \$313.9 million, respectively, of which \$183.8 million and \$207.2 million, respectively, was paid in cash in the subsequent year. All patronage distributions require the approval of our Board of Directors.

Capitalization Requirements

In accordance with the Farm Credit Act, eligible borrowers are required to purchase equity in CoBank as a condition of borrowing. The minimum initial borrower investment is equal to the lesser of one thousand dollars or 2 percent of the amount of the loan. The minimum initial investment is generally received in cash at the time the borrower receives the loan proceeds.

Association customers are required to invest in our common stock, as discussed in Note 17.

Most international borrowers, customers of FCL and certain other borrowers are not required to purchase, nor do they own, equity in CoBank. Likewise, they do not participate in patronage distributions.

Retirements of common stock, if any, are calculated annually after a determination by the Board of Directors of a target equity level. Net cash retirements are made at the sole discretion of the Board of Directors and are at book value not to exceed par or face value.

Regulatory Capitalization Requirements and Restrictions

The FCA's capital adequacy regulations require us to maintain certain minimum capital requirements and collateral standards.

We are prohibited from reducing permanent capital by retiring stock or making certain other distributions to shareholders unless prescribed capital standards are met. All such minimum regulatory capital requirements and collateral standards were met as of December 31, 2010.

At December 31, 2010, our permanent capital, total surplus, core surplus and net collateral ratios exceeded the regulatory minimums as noted in the following table.

| Capital Ratios as of December 31, | | | | |
|-----------------------------------|------------------------|---------|---------|---------|
| | Regulatory Minimums | 2010 | 2009 | 2008 |
| Permanent | | | | |
| Capital Ratio | 7.0 % | 14.30 % | 15.29 % | 14.75 % |
| Total Surplus | | | | |
| Ratio | 7.0 | 13.96 | 15.01 | 14.61 |
| Core Surplus | | | | |
| Ratio* | 3.5 | 8.42 | 8.77 | 7.98 |
| Net Collateral | | | | |
| Ratio | 104.0 ** | 108.03 | 108.67 | 107.75 |

* Beginning January 1, 2008, core surplus includes a significant portion of common stock as a result of a favorable FCA determination granted in March 2008 on a temporary basis.

** The regulatory minimum net collateral ratio is 103.0 percent, but the FCA requires the higher 104.0 percent during the period in which we have Series A preferred stock or subordinated debt outstanding.

The ratios are calculated in accordance with FCA regulations, as summarized below.

- The permanent capital ratio is quarterly average permanent capital (generally shareholders' equity and subordinated debt subject to certain limitations) as a percentage of quarterly average risk-adjusted assets.
- The total surplus ratio is quarterly average total surplus (generally shareholders' equity, net of purchased stock, and subordinated debt subject to certain limitations) as a percentage of quarterly average risk-adjusted assets.
- The core surplus ratio is quarterly average core surplus (generally unallocated retained earnings, non-cumulative preferred stock and, beginning January 1, 2008, a significant portion of common stock) as a percentage of quarterly average risk-adjusted assets.
- The net collateral ratio is net collateral (generally net loans and investments) divided by total liabilities, as adjusted to exclude subordinated debt (subject to certain limitations) and the fair value of certain derivatives.

Preferred Stock

The following table summarizes our outstanding preferred stock at December 31, 2010.

| Preferred Stock as of December 31, 2010 | | | | |
|---|---|---|---|---|
| | Series A | Series B | Series C | Series D |
| Type | Cumulative Perpetual | Cumulative Perpetual | Non-Cumulative Subordinated Perpetual | Non-Cumulative Subordinated Perpetual |
| Issue Date | June 2001 | November 2003 | July 2008 | August 2009 |
| Shares Outstanding (000) | 3,265 | 4,000 | 4,000 | 2,735 |
| Amount Outstanding (000) | \$163,250 | \$200,000 | \$200,000 | \$136,750 |
| Par Value (per share) | \$50 | \$50 | \$50 | \$50 |
| Dividend Rate (%) | 7.814% | 7.00% | 11.00% | 11.00% |
| Change in Dividend Rate (% and dates) | Greater of 7.814% or 3-month USD LIBOR + 2.72% on July 1, 2011 and + 4.72% on July 1, 2016 | n/a | 3-month USD LIBOR + 6.79% on July 1, 2013 | n/a |
| Dividend Frequency | Quarterly | Quarterly | Quarterly | Quarterly |
| Optional Redemption Begins (date) | Quarterly calls on or after July 1, 2011 at par plus accrued dividends | Quarterly calls on or after January 2, 2009 at par plus accrued dividends | Annual calls on or after July 1, 2013 at par plus accrued dividends | Quarterly calls on or after October 1, 2014 at par plus accrued dividends |
| Rank as to Dividends and Upon Liquidation | Equal to Series B | Equal to Series A | Junior to Series A and B; equal to Series D | Junior to Series A and B; equal to Series C |

In August 2009, \$136.8 million of our Series A cumulative perpetual preferred stock (Series A preferred stock) was exchanged for Series D non-cumulative subordinated perpetual preferred stock (Series D preferred stock), representing 2.735 million shares at \$50 per share outstanding. Upon completion of this exchange transaction, \$163.2 million of Series A preferred stock, representing 3.265 million shares at \$50 per share, remained outstanding. In connection with this exchange, holders of the Series A preferred stock voted to eliminate certain restrictions on our ability to make open market purchases or exchanges of the Series A preferred stock. The exchange of the Series A preferred stock for new Series D preferred stock resulted in a higher core surplus ratio, thereby enhancing our capital position.

In 2008, our shareholders approved a measure allowing CoBank to issue or reissue preferred stock, up to the bylaw limit of \$1.0 billion outstanding, at any time through September 2018. This measure allows us to access outside capital more quickly and efficiently in response to dynamic market conditions, without the necessity of obtaining shareholder approval for each issuance. However, any such issuance would remain subject to FCA approval.

If preferred stock dividends have not been paid for six quarters on Series A or Series B preferred stock, or 18 months on Series C or Series D preferred stock, the preferred stockholders will have the right to appoint two non-voting observers to attend our Board of Directors meetings until all accumulated dividends are paid in the case of cumulative preferred stock, and until full dividends for a one year period are paid in the case of non-cumulative preferred stock. In addition, other than pursuant to an order issued by our regulator, we may not enter into agreements restricting our ability to declare or pay preferred stock dividends.

All stock retirements, including preferred stock redemptions, require the approval of our Board of Directors.

Description of Equities

In March 2009, our voting shareholders approved changes to our bylaws to convert all previously existing classes of common equity, including non-voting participation certificates, into a single class of common equity – Class A common stock – and to afford voting rights to certain borrowers that are not organized as cooperatives. Class A shareholders that are directly eligible to borrow from CoBank, that borrow on a patronage basis and that are active borrowers have voting rights. All other shareholders do not have voting rights. The number of voting shareholders increased by approximately 27 percent as a result of these bylaw changes, which were effective April 1, 2009.

Information regarding preferred stock and common stock at December 31, 2010 is shown below.

| | Stock | | |
|---------------------------------|-----------|-----------|-----------|
| | Preferred | Class A | Class A |
| Shares Authorized (000) | 20,000 | Unlimited | Unlimited |
| Shares Outstanding (000) | 14,000 | 852 | 14,838 |
| Voting or Nonvoting | Nonvoting | Nonvoting | Voting |
| Par / Face Value (per share) | \$ 50 | \$ 100 | \$ 100 |

Holders of equities may not pledge, hypothecate or otherwise grant a security interest in such equities except as consented to by the Bank under FCA regulations. We have a statutory first lien on CoBank common stock. Only preferred stock pays dividends.

In case of liquidation or dissolution, preferred stock, common stock and unallocated retained earnings would be distributed to shareholders, after the payment of all liabilities pursuant to FCA regulations, in the following order:

- (1) retirement of all Series A and Series B preferred stock at par plus all accrued but unpaid dividends;
- (2) retirement of all Series C and Series D preferred stock at par plus all accrued but unpaid dividends for the then current dividend period;
- (3) retirement of all common stock at par;
- (4) retirement of all patronage surplus (a component of unallocated retained earnings) in amounts equal to the face amount of the applicable nonqualified written notices of allocation or such other notice; and
- (5) remaining unallocated retained earnings and reserves shall be paid to the holders of common stock in proportion to patronage to the extent possible.

Note 8 – Employee Benefit Plans and Incentive Compensation Plans

Employee Benefit Plans

We have employer-funded, qualified defined benefit pension plans, which are noncontributory and cover employees hired prior to January 1, 2007. Depending on the date of hire, benefits are determined either by a formula based on years of service and final average pay, or by the accumulation of a cash balance with interest credits and contribution credits based on years of service and eligible compensation. Effective January 1, 2007, the Bank closed the remaining qualified defined benefit pension plan to new participants.

We also have a noncontributory, unfunded nonqualified supplemental executive retirement plan (SERP) covering all senior officers as of December 31, 2010, and specified other senior managers, as well as a noncontributory, unfunded nonqualified executive retirement plan (ERP) designed to provide enhanced retirement benefits to two senior officers employed pursuant to employment agreements. The defined benefit pension plans, SERP and ERP are collectively referred to as Retirement Plans. We hold assets in a trust fund related to our SERP and ERP; however, such funds remain Bank

assets and are not included as plan assets in the accompanying disclosures.

We have a 401(k) retirement savings plan pursuant to which we match a certain percentage of employees' elective contributions. In addition, under this plan, employees hired on or after January 1, 2007 receive additional employer defined contributions. For eligible senior managers, including our senior officers, we also have a nonqualified deferred compensation plan, which includes benefits not provided under the employee savings plan due to certain Internal Revenue Code limitations. Our contributions to the 401(k) retirement savings plan, which are recorded as employee compensation expense, were \$3.9 million, \$3.8 million and \$3.4 million for 2010, 2009 and 2008, respectively.

All retirement-eligible employees are also currently eligible for other postretirement benefits, which primarily include access to healthcare benefits. Substantially all participants pay the full premiums associated with these other postretirement healthcare benefits. Participant contributions are adjusted annually.

The following table provides a summary of the changes in the plans' projected benefit obligations and fair values of assets over the three-year period ended December 31, 2010, as well as a statement of funded status as of December 31 of each year.

| | Retirement Plans | | | Other Postretirement Benefits | | |
|--|--------------------|-------------------|--------------------|-------------------------------|-------------------|-------------------|
| | 2010 | 2009 | 2008 | 2010 | 2009 | 2008 |
| Change in Projected Benefit Obligation: | | | | | | |
| Benefit Obligation at Beginning of Year | \$ 161,616 | \$ 141,722 | \$ 128,974 | \$ 4,171 | \$ 4,189 | \$ 3,404 |
| Service Cost | 6,117 | 5,735 | 6,637 | 178 | 158 | 169 |
| Interest Cost on Benefit Obligation | 8,960 | 8,865 | 10,071 | 228 | 255 | 261 |
| Plan Participant Contributions | - | - | - | 468 | 416 | 332 |
| Plan Amendments | - | - | 283 | - | - | - |
| Curtailment ⁽¹⁾ | (629) | - | - | - | - | - |
| Actuarial Loss (Gain) | 10,538 | 11,305 | 4,855 | 782 | (397) | 462 |
| Transfers | 140 | - | - | - | - | - |
| Benefits Paid | (7,450) | (6,011) | (9,098) | (485) | (450) | (439) |
| Projected Benefit Obligation at End of Year | 179,292 | 161,616 | 141,722 | 5,342 | 4,171 | 4,189 |
| Change in Plan Assets: | | | | | | |
| Fair Value of Plan Assets at Beginning of Year | 156,645 | 110,943 | 126,939 | - | - | - |
| Actual Return on Plan Assets | 14,201 | 28,338 | (30,929) | - | - | - |
| Employer Contributions | 4,260 | 23,375 | 24,031 | 17 | 34 | 107 |
| Transfers | 140 | - | - | - | - | - |
| Benefits Paid | (7,450) | (6,011) | (9,098) | (485) | (450) | (439) |
| Plan Participant Contributions | - | - | - | 468 | 416 | 332 |
| Fair Value of Plan Assets at End of Year | 167,796 | 156,645 | 110,943 | - | - | - |
| Funded Status – Fair Value of Plan Assets | | | | | | |
| Less Than Projected Benefit Obligation | (11,496) | (4,971) | (30,779) | (5,342) | (4,171) | (4,189) |
| Net Amount Recognized - December 31 | \$ (11,496) | \$ (4,971) | \$ (30,779) | \$ (5,342) | \$ (4,171) | \$ (4,189) |

⁽¹⁾ Curtailment results from the departure of senior officers from the ERP.

The projected benefit obligation and the accumulated benefit obligation for the Retirement Plans as of December 31 of each year are as follows.

| | 2010 | 2009 | 2008 |
|--|-------------------|-------------------|-------------------|
| Projected Benefit Obligation: | | | |
| Funded Plans | \$ 154,366 | \$ 141,164 | \$ 125,408 |
| Unfunded SERP/ERP | 24,926 | 20,452 | 16,314 |
| Total | \$ 179,292 | \$ 161,616 | \$ 141,722 |
| Accumulated Benefit Obligation: | | | |
| Funded Plans | \$ 135,881 | \$ 123,373 | \$ 109,036 |
| Unfunded SERP/ERP | 19,132 | 11,686 | 11,310 |
| Total | \$ 155,013 | \$ 135,059 | \$ 120,346 |

The \$167.8 million in fair value of plan assets shown in the table on page 83 relates only to the qualified retirement plans. As depicted in the preceding table, such plans had a projected benefit obligation and an accumulated benefit obligation of \$154.4 million and \$135.9 million, respectively, as of December 31, 2010.

We hold assets in trust accounts related to our SERP and ERP plans. Such assets had a fair value of \$15.5 million as of December 31, 2010, which is included in "Other Assets" in the consolidated balance sheet. Unlike the assets related to the qualified plans, those funds remain Bank assets and would be subject to general creditors in a bankruptcy or liquidation. Accordingly, they are not included as part of the assets in the table on page 83. As depicted in the preceding table, our SERP and ERP plans had a projected benefit obligation and an accumulated benefit obligation of \$24.9 million and \$19.1 million, respectively, as of December 31, 2010.

The following table provides the amounts recognized in the consolidated balance sheets as of December 31 of each year.

| | Retirement Plans | | | Other Postretirement Benefits | | |
|-------------------------------|--------------------|-------------------|--------------------|-------------------------------|-------------------|-------------------|
| | 2010 | 2009 | 2008 | 2010 | 2009 | 2008 |
| Prepaid Pension Assets | \$ 13,430 | \$ 15,481 | \$ - | \$ - | \$ - | \$ - |
| Accrued Benefit Liabilities | (24,926) | (20,452) | (30,779) | (5,342) | (4,171) | (4,189) |
| Net Amounts Recognized | \$ (11,496) | \$ (4,971) | \$ (30,779) | \$ (5,342) | \$ (4,171) | \$ (4,189) |

The following table presents the components of net periodic benefit cost for the plans.

| | Retirement Plans | | | Other Postretirement Benefits | | |
|-------------------------------------|------------------|-----------------|-----------------|-------------------------------|---------------|---------------|
| | 2010 | 2009 | 2008 | 2010 | 2009 | 2008 |
| Service Cost | \$ 6,117 | \$ 5,735 | \$ 5,310 | \$ 178 | \$ 158 | \$ 135 |
| Interest Cost on Benefit Obligation | 8,960 | 8,865 | 8,057 | 228 | 255 | 208 |
| Expected Return on Plan Assets | (12,902) | (11,275) | (9,773) | - | - | - |
| Amortization of Prior Service Cost | 284 | (228) | (286) | (12) | (16) | (16) |
| Curtailment Gain ⁽¹⁾ | (351) | - | - | - | - | - |
| Recognized Actuarial Loss (Gain) | 1,496 | 1,340 | 526 | (152) | (131) | (214) |
| Net Periodic Benefit Cost | \$ 3,604 | \$ 4,437 | \$ 3,834 | \$ 242 | \$ 266 | \$ 113 |

⁽¹⁾ Curtailment gain results from the departure of senior officers from the ERP.

We anticipate that our total pension expense for all retirement plans will be approximately \$5.3 million in 2011, as compared to \$3.6 million in 2010.

The following table displays the amounts included in accumulated other comprehensive loss (OCL), a component of shareholders' equity, related to our pension and other postretirement benefit plans.

| Amounts Included in Accumulated OCL (Pre-Tax) at December 31, 2010 | Qualified Retirement Plans | Nonqualified Retirement Plans | Other Postretirement Benefits | Total |
|--|----------------------------|-------------------------------|-------------------------------|------------------|
| Net Actuarial Loss (Gain) | \$ 51,850 | \$ 11,232 | \$ (1,516) | \$ 61,566 |
| Prior Service Cost (Credit) | (2,051) | 998 | - | (1,053) |
| Amount Recognized in Accumulated OCL* | \$ 49,799 | \$ 12,230 | \$ (1,516) | \$ 60,513 |

* Amount recognized in accumulated OCL, net of tax, is \$37.5 million as of December 31, 2010. Approximately \$2.0 million, net of tax, will be amortized from OCL into net periodic benefit cost in 2011.

Assumptions

We measure plan obligations and annual expense using assumptions designed to reflect future economic conditions. As the bulk of pension benefits will not be paid for many years, the computations of pension expenses and benefits are based on assumptions about discount rates, estimates of annual increases in compensation levels and expected rates of return on plan assets.

The weighted average rate assumptions used in the measurement of our benefit obligations are as follows:

| | 2010 | 2009 | 2008 |
|-------------------------------|--------|--------|--------|
| Discount Rate | 5.35 % | 5.70 % | 6.35 % |
| Rate of Compensation Increase | 5.00 | 5.00 | 5.00 |

The weighted average rate assumptions used in the measurement of our net periodic benefit cost are as follows:

| | 2010 | 2009 | 2008 |
|---|--------|--------|--------|
| Discount Rate | 5.70 % | 6.35 % | 6.35 % |
| Expected Rate of Return on Plan Assets (Qualified Plans Only) | 8.00 | 8.00 | 8.00 |
| Rate of Compensation Increase | 5.00 | 5.00 | 5.00 |

The discount rates are calculated using a spot yield curve method developed by an independent actuary. The approach maps a high-quality bond yield curve to the duration of the plans' liabilities, thus approximating each cash flow of the liability stream to be discounted at an interest rate specifically applicable to its respective period in time. Due to the turmoil in the financial markets at the end of 2008, bonds of many highly-rated financial institutions were trading at significantly higher yields at that time than comparably rated bonds of companies in other industries. As a result, for 2008 only, we modified our discount rate methodology by using a yield curve that incorporated a broader population of high quality bonds thereby diluting the effect of the higher-yielding financial institution bonds.

We establish the expected rate of return on plan assets based on a review of past and expected future anticipated returns on plan assets. The expected rate of return on plan assets assumption also matches the pension plans' long-term interest rate assumption used for funding purposes.

Assumed health care cost trend rates have an effect on the amounts reported for other postretirement benefits. For measurement purposes, an 8 percent annual rate of increase in the per capita cost of covered health care benefits was assumed for 2010. The rate was assumed to decrease by 0.5 percent each year through 2016 to 5 percent and remain at that level thereafter. A 1-percentage-point increase in the assumed health care cost trend rate would increase total annual service and interest cost by \$90 and total other postretirement benefit obligations by \$429, as of January 1, 2010. Conversely, a 1-percentage-point decrease in the assumed health care cost trend rate would decrease total annual service and interest cost by \$43 and total other postretirement benefit obligations by \$405.

Plan Assets

The asset allocation target ranges for the pension plans follow the investment policy adopted by our retirement trust committee. This policy provides for a certain level of trustee flexibility in selecting target allocation percentages. The actual asset allocations at December 31, 2010, 2009 and 2008 are shown in the following table, along with the adopted range for target allocation percentages by asset class. The actual allocation percentages reflect the quoted market values at year-end and may vary during the course of the year. Plan assets are generally rebalanced to a level within the target range each year at the direction of the trustees.

| Retirement Benefit Plan Assets | | | | |
|--|-------------------------|---|--------------|--------------|
| Asset Category | Target Allocation Range | Percentage of Plan Assets at December 31, | | |
| | | 2010 | 2009 | 2008 |
| Domestic Equity | 40-50 % | 43 % | 43 % | 35 % |
| Domestic Fixed Income | 35-50 | 37 | 48 | 59 |
| International Equity | 0-10 | 10 | 9 | 6 |
| Emerging Markets Equity and Fixed Income | 0-10 | 4 | - | - |
| Real Assets | 0-5 | 6 | - | - |
| Total | 100 % | 100 % | 100 % | 100 % |

The assets of the pension plans consist primarily of investments in various domestic equity, international equity and bond funds. These funds do not contain any significant investments in a single entity, industry, country or commodity, thereby mitigating concentration risk. No CoBank stock or debt, or that of any other System institution, is included in these investments.

The following table presents major categories of plan assets that are measured at fair value at December 31, 2010 for each of the fair value hierarchy levels as defined in Note 12.

| Fair Value Measurements | | | |
|---|-------------------|------------------|-------------------|
| December 31, 2010 | | | |
| Asset Category | Level 1 | Level 2 | Total |
| Cash | \$ 645 | \$ - | \$ 645 |
| Domestic Equity: | | | |
| Large-cap Growth Funds ⁽¹⁾ | 35,739 | 28,049 | 63,788 |
| Small-cap Growth Fund ⁽¹⁾ | - | 9,126 | 9,126 |
| International Equity: | | | |
| International Fund ⁽²⁾ | 16,214 | - | 16,214 |
| Fixed Income: | | | |
| Total Return Fund ⁽³⁾ | 61,451 | - | 61,451 |
| Emerging Markets: | | | |
| Equity and Fixed Income Fund ⁽⁴⁾ | - | 7,297 | 7,297 |
| Real Assets: Gold Fund ⁽⁵⁾ | 9,275 | - | 9,275 |
| Total | \$ 123,324 | \$ 44,472 | \$ 167,796 |

⁽¹⁾ Funds invest primarily in diversified portfolios of common stocks of U.S. companies in various industries, including healthcare, information technology, consumer goods and services, and energy.

⁽²⁾ Fund invests primarily in a diversified portfolio of equities of non-U.S. companies in various industries, including financial services, consumer goods, healthcare, industrial materials and telecommunications.

⁽³⁾ Fund invests primarily in a diversified portfolio of investment grade debt securities and cash instruments.

⁽⁴⁾ Fund invests in equities and corporate debt securities of companies located in emerging international markets. Industries include telecommunications, information technology and financial services. Fund also invests in the sovereign debt of countries, including Brazil, Turkey, South Korea and Mexico.

⁽⁵⁾ Fund invests in gold bullion.

Level 1 plan assets are funds with quoted daily net asset values that are directly observable by market participants. The fair value of these funds is the net asset value at close of business on the reporting date. Level 2 plan assets are funds with quoted net asset values that are not directly observable by market participants. A significant portion of the underlying investments in these funds have individually observable market prices, which are utilized by the plan's trustee to determine a net asset value at close of business on the reporting date. There were no Level 3 plan assets at December 31, 2010.

Investment strategy and objectives are described in the pension plans' formal investment policy document. The basic strategy and objectives as adopted in the investment policy are:

- Manage portfolio assets with a long-term time horizon appropriate for the participant demographics and cash flow requirements;
- Optimize long-term funding requirements by generating rates of return sufficient to fund liabilities and exceed the long-term rate of inflation; and
- Provide competitive investment returns and reasonable risk levels when measured against appropriate benchmarks.

Expected Contributions

We expect to contribute approximately \$4.0 million to our funded, qualified defined benefit pension plans in 2011 and a net \$0.1 million, after reflecting collected retiree premiums, to our other postretirement benefit plans in 2011. We also expect to contribute approximately \$1.0 million to \$2.0 million to our trust funds related to our SERP and ERP, respectively, in 2011. Our actual 2011 contributions could differ from the estimates noted above.

Estimated Future Benefit Payments

We expect to make the following benefit payments, which reflect expected future service, as appropriate.

| Year: | Estimated Benefit Payments | |
|--------------|----------------------------|-------------------------------|
| | Retirement Benefits | Other Postretirement Benefits |
| 2011 | \$ 9,927 | \$ 513 |
| 2012 | 11,924 | 482 |
| 2013 | 11,945 | 467 |
| 2014 | 12,423 | 478 |
| 2015 | 16,217 | 510 |
| 2016 to 2020 | 83,085 | 2,433 |

Change in Measurement Date

Effective January 1, 2008, in accordance with a new GAAP requirement, we changed the measurement date for plan assets and liabilities to coincide with our fiscal year-end. We had historically used September 30 as the measurement date for our pension and other postretirement benefit plans. As a result of this change, pension and postretirement benefit expense measured for the three-month period October 1, 2007 to December 31, 2007 (determined using the September 2007 measurement date) of \$1.0 million (\$0.6 million net of tax) was recorded in retained earnings at January 1, 2008.

Incentive Compensation Plans

We have a broad-based, Board-approved short-term incentive compensation plan covering substantially all employees pursuant to which annual cash awards may be earned. Criteria used to determine amounts payable include the achievement of our specified financial measures and strategic business objectives, which are approved annually by the Compensation Committee of the Board of Directors. Individual performance is also considered in the determination of the amount payable.

We also have a Board-approved long-term incentive compensation plan, pursuant to which cash awards may be earned by senior officers and specified other senior managers who have a significant impact on long-term financial performance. Criteria used to determine amounts payable include achievement of certain Bank financial targets and strategic business objectives over a three-year performance period. Cash awards are to be paid subsequent to completion of each three-year period, subject to approval by the Compensation Committee of the Board of Directors.

Under the terms of the short-term incentive compensation plan, a minimum return on active patron stock investment must be achieved in order for a payout to be approved. Likewise, a minimum return on active patron stock investment must be achieved in each year within the three-year performance period for a full payout under the long-term incentive plan. The minimum return on active patron stock investment was 11 percent for all performance periods disclosed herein.

Note 9 – Income Taxes

The components of the provision for income taxes are as follows:

| Year Ended December 31, | 2010 | 2009 | 2008 |
|-----------------------------|-------------------|-------------------|-------------------|
| Current: | | | |
| Federal | \$ 117,056 | \$ 86,256 | \$ 45,982 |
| State | 15,134 | 18,612 | 7,579 |
| Total Current | 132,190 | 104,868 | 53,561 |
| Deferred: | | | |
| Federal | 24,209 | 59,425 | 64,418 |
| State | 3,028 | 1,984 | 9,427 |
| Total Deferred | 27,237 | 61,409 | 73,845 |
| Total | \$ 159,427 | \$ 166,277 | \$ 127,406 |
| Comprehensive Tax Provision | | | |
| Allocable to: | | | |
| Pre-Tax Income | \$ 159,427 | \$ 166,277 | \$ 127,406 |
| Shareholders' Equity - | | | |
| Amounts Allocated to: | | | |
| Investment Securities | 26,451 | 64,759 | (52,298) |
| Derivatives | (2,386) | 279 | (628) |
| Pension Liability | (3,089) | 2,705 | (18,631) |
| Total | \$ 180,403 | \$ 234,020 | \$ 55,849 |

The components of deferred tax assets and liabilities are shown below.

| December 31, | 2010 | 2009 | 2008 |
|---------------------------------------|----------------|----------------|----------------|
| Reserve for Credit Exposure | \$ 159,930 | \$ 149,800 | \$ 173,965 |
| Employee Benefits | 30,447 | 26,299 | 38,263 |
| Loan Origination Fees | 19,701 | 21,006 | 18,537 |
| Unrealized Net Losses on | | | |
| Investment Securities | | | |
| and Derivatives | - | 1,184 | 66,222 |
| Other Deferred Tax Assets | 51,921 | 35,067 | 21,973 |
| Gross Deferred Tax Assets | 261,999 | 233,356 | 318,960 |
| Leasing | 367,603 | 312,977 | 271,173 |
| Unrealized Net Gains on | | | |
| Investment Securities | 22,881 | - | - |
| and Derivatives | | | |
| Other Deferred Tax Liabilities | 14,966 | 15,617 | 13,874 |
| Gross Deferred Tax Liabilities | 405,450 | 328,594 | 285,047 |
| Net Deferred Tax | | | |
| (Liabilities) Assets | \$ (143,451) | \$ (95,238) | \$ 33,913 |

Deferred income taxes are provided for the change in temporary differences between the basis of certain assets and liabilities for financial reporting and income tax reporting purposes. The expected future tax rates are based upon enacted tax laws.

The effective tax rates for the years ended December 31, 2010, 2009 and 2008 of 20.6 percent, 22.7 percent and 19.3 percent, respectively, were significantly less than the statutory income tax rate primarily due to the distribution or planned distribution of \$284.6 million, \$268.9 million and \$313.9 million, respectively, of taxable income as qualified patronage distributions, which are tax deductible as permitted by Subchapter T of the Internal Revenue Code.

| Year Ended December 31, | 2010 | 2009 | 2008 |
|-----------------------------------|-------------------|-------------------|-------------------|
| Federal Tax at Statutory Rate | \$ 270,618 | \$ 256,092 | \$ 231,294 |
| State Tax, Net | 11,120 | 14,145 | 11,656 |
| Patronage Distributions | (99,130) | (94,777) | (109,134) |
| Tax-Exempt Activities | (21,348) | (760) | (5,534) |
| Other | (1,833) | (8,423) | (876) |
| Provision for Income Taxes | \$ 159,427 | \$ 166,277 | \$ 127,406 |

We will distribute 37 percent of income before income taxes to our shareholders as qualified patronage distributions related to 2010, compared to 37 percent for 2009 and 47 percent for 2008.

A reconciliation of the beginning and ending amount of unrecognized tax benefits, excluding interest and penalties, is as follows:

| Year Ended December 31, 2010 | |
|--|-----------------|
| Balance at Beginning of Year | \$ 5,761 |
| Additions Based on Tax Positions Related to the Current Year | 757 |
| Additions for Tax Positions of Prior Years | 325 |
| Reductions for Tax Positions of Prior Years | (2,515) |
| Lapse of Applicable Statute of Limitations | (226) |
| Balance at End of Year | \$ 4,102 |

The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate is \$3.7 million. We do not currently believe that the unrecognized tax benefits will change significantly within the next 12 months.

We recognize interest and penalties accrued related to unrecognized tax benefits as a component of the provision for income taxes. During the year ended December 31, 2010, we recognized a decrease of approximately \$1.8 million in interest and penalties. We had approximately \$1.7 million and \$3.5 million of interest and penalties accrued at December 31, 2010 and 2009, respectively.

We file income tax returns in federal and various state jurisdictions. With few exceptions, the Bank is no longer subject to federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2007.

Note 10 – Financial Instruments With Off-Balance Sheet Risk

We utilize various financial instruments with off-balance sheet risk to satisfy the financing needs of our borrowers and to manage our exposure to interest rate risk. Such financial instruments include commitments to extend credit and commercial letters of credit. Commitments to extend credit are agreements to lend to a borrower provided that certain contractual conditions are met. Commercial letters of credit are agreements to pay a beneficiary under conditions specified in the letter of credit. Commitments and letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2010, outstanding commitments to extend credit and commercial letters of credit were \$22.6 billion and \$401.6 million, respectively.

Since many of these commitments may expire without being drawn, the total commitments do not necessarily represent future cash requirements. Our exposure to many of these commitments is mitigated by borrowing base requirements contained in loan agreements. However, these credit-related financial instruments have off-balance sheet credit risk because their amounts are not reflected on the consolidated balance sheets until funded or drawn upon. The credit risk associated with issuing commitments and commercial letters of credit is substantially the same as that involved in extending loans to borrowers. Therefore, management applies the same credit policies to these commitments. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. As discussed in Note 2, we maintain a reserve for unfunded commitments.

For a fee, we provide financial standby letters of credit for borrowers, which are irrevocable commitments to guarantee payment of a specified financial obligation. We also provide performance standby letters of credit which are irrevocable agreements by us, as a guarantor, to make payments to the guaranteed party in the event a specified third-party fails to perform under a nonfinancial contractual obligation, such as a third-party failing to timely deliver certain commodities at a specified time and place. We also issue indemnification agreements that function like guarantees. These indemnification agreements contingently require us, as the indemnifying party (guarantor), to make payments to an indemnified party under certain specified circumstances. Certain recourse provisions would enable us, as a guarantor, to recover from third parties any of the amounts paid under guarantees, thereby limiting our maximum potential exposure.

As of December 31, 2010, the maximum potential amount of future payments that we may be required to make under our outstanding standby letters of credit was \$1.5 billion, with a fair value of \$10.8 million, which is included in other liabilities in the consolidated balance sheet. The current status of the payment/performance risk of the standby letters of credit guarantee is based on internal customer credit ratings that we use to manage our credit risk. These outstanding standby letters of credit have expiration dates ranging from January 2011 to February 2033.

The notional amounts and related activity of derivatives at December 31, 2010 are shown in the following table.

Activity in the Notional Amounts of Derivative Financial Instruments

| (\$ in Millions) | Swaps | Caps | Spots and Forwards | Total |
|--------------------------|-----------|----------|--------------------|-----------|
| December 31, 2009 | \$ 30,748 | \$ 1,600 | \$ 218 | \$ 32,566 |
| Additions /Accretion | 4,700 | 528 | 2,699 | 7,927 |
| Maturities /Amortization | (6,489) | (72) | (2,718) | (9,279) |
| Terminations | (260) | - | - | (260) |
| December 31, 2010 | \$ 28,699 | \$ 2,056 | \$ 199 | \$ 30,954 |

Accounting for Derivative Instruments and Hedging Activities

We record derivatives as assets or liabilities at their fair value on the consolidated balance sheets. We record changes in the fair value of a derivative in current period earnings or accumulated other comprehensive income (loss), depending on the use of the derivative and whether it qualifies for hedge accounting. For fair value hedge transactions that hedge changes in the fair value of assets or liabilities, changes in the fair value of the derivative will generally be offset in the income statement by changes in the hedged item's fair value attributable to the risk being hedged. For cash flow hedge transactions, in which we hedge the variability of future cash flows related to a variable-rate asset or liability, changes in the fair value of the derivative are reported in accumulated other comprehensive income (loss). The gains and losses on the derivatives that we report in accumulated other comprehensive income (loss) will be reclassified as earnings in the periods in which earnings are affected by the variability of the cash flows of the hedged item. We record the ineffective portion of all hedges in current period earnings.

For our customer transactions, which are not designated as hedging instruments, we record the related changes in fair value in current period earnings. We substantially offset this risk transference by concurrently entering into offsetting agreements with counterparties, with the changes in fair value of these transactions also recorded in current period earnings.

Note 11 – Derivative Financial Instruments and Hedging Activities

Risk Management Objectives and Strategies

We maintain an overall interest rate risk management strategy that incorporates the use of derivative financial instruments to manage liquidity and minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. Our goal is to manage interest rate sensitivity by modifying the repricing frequency or effective maturity of certain balance sheet assets and liabilities. We also maintain a foreign exchange risk management strategy to reduce the impact of currency fluctuations on our relatively nominal amount of foreign currency-denominated loans. As a result of interest rate and foreign exchange rate fluctuations, fixed-rate assets and liabilities will appreciate or depreciate in market value. The effect of this unrealized appreciation or depreciation is expected to be substantially offset by gains and losses on the derivative instruments that are linked to these assets and liabilities. Interest rate and foreign exchange fluctuations also cause interest income and interest expense of variable-rate assets and liabilities to increase or decrease. The effect of this variability in earnings is expected to be substantially offset by gains and losses on the derivative instruments that are linked to these assets and liabilities.

Uses of Derivatives

To achieve risk management objectives and satisfy the financing needs of our borrowers, we execute various derivative transactions with other financial institutions. Derivatives (primarily interest rate swaps) are used to manage liquidity and the interest rate risk arising from maturity and repricing mismatches between assets and liabilities. Under interest rate swap arrangements, we agree with a third-party to exchange, at specified intervals, payment streams calculated on a specified notional amount, with at least one payment stream based on a specified floating-rate index. We use a variety of interest rate swaps including the exchange of floating-rate for fixed-rate swaps and fixed-rate for floating-rate swaps with payment obligations tied to specific indices. In addition, we execute foreign exchange spot and forward contracts to manage currency risk on loans denominated in foreign currencies. We also enter into derivatives for our customers as a service to enable them to transfer, modify or reduce their interest rate risk and foreign exchange risk by transferring such risk to us. We substantially offset this risk transference by concurrently entering into offsetting agreements with counterparties.

Fair Value Hedges

The majority of the fair value hedging activity relates to entering into interest rate swaps primarily to convert our non-prepayable fixed-rate debt to floating-rate debt to achieve our liquidity management strategy. The amount converted depends on contractual interest rates and maturities. For the remaining fair value hedges, we enter into receive-fixed, pay-floating swaps to align our equity positioning strategy with our risk management strategy. For fair value hedges, the amount of hedge ineffectiveness is recognized as net interest income in current period earnings.

Cash Flow Hedges

We purchase interest rate caps to hedge cap risk embedded within a portion of our floating-rate investment securities. The interest rate caps hedge floating-rate debt cash flows that fund the cash flows from floating-rate investment securities. If the strike rates in the purchased interest rate caps are exceeded, we receive cash flows on the derivative to hedge our floating-rate funding exposure above such strike levels. We also enter into foreign exchange spot and forward contracts to manage currency risk on loans denominated in foreign currencies. Typically, foreign currency contracts are purchased to fund the principal cash flows of the loan and simultaneously sold to lock in the principal and interest cash flows upon repricing or maturity date of the loan. For cash flow hedges, the amount of hedge ineffectiveness, the amount excluded from effectiveness assessment, and the amounts reclassified from accumulated other comprehensive income (loss) into current period earnings are all reflected in net interest income. At December 31, 2010, we expect that \$2.4 million of expense will be reclassified from other comprehensive loss into the income statement in the next 12 months, based on the anticipated cash flows of existing financial instruments. The maximum term over which we are hedging our exposure to the variability of future cash flows for all forecasted transactions is approximately six years.

Derivatives Not Designated As Hedges

Derivative agreements with our customers and the related offsetting derivative agreements with counterparties are not designated as hedging instruments and do not receive hedge accounting treatment. Accordingly, any changes in the fair value of these customer related derivatives are recognized immediately as noninterest income/expense in current period earnings.

Counterparty Credit Risk

The use of derivatives for risk management introduces credit risk related to counterparties and market risk related to movements in interest rates. Generally, when the fair value of a derivative contract is positive, the counterparty owes us, thus creating a performance risk. When the fair value of the derivative contract is negative, we owe the counterparty, and therefore assume no performance risk.

To minimize the risk of credit losses, all derivative transactions are governed by master swap agreements, which include netting agreements requiring the net settlement of covered contracts with the same counterparty in the event of default by the other party. The "net" mark-to-market exposure represents the netting of the positive and negative exposures with that counterparty. The master swap agreements also include bilateral collateral arrangements, requiring the Bank or our counterparties to post collateral with daily posting and zero thresholds. Derivative transactions with our customers are secured through our loan agreements. We record derivative exposures and related cash collateral balances at gross amounts in our consolidated balance sheets. As of December 31, 2010, our counterparties had posted \$891.0 million in cash and \$141.4 million in securities as collateral with us. The maximum amount of losses we could be exposed to in the event of nonperformance by dealer counterparties to our derivative positions, net of collateral held by us, was \$10.6 million, \$46.8 million and \$396.4 million at December 31, 2010, 2009 and 2008, respectively.

During 2009, we terminated approximately \$115.0 million in notional value of interest rate swaps for asset-liability management purposes. During 2008, we terminated approximately \$2.1 billion in notional value of interest rate swaps to reduce our credit exposure with two counterparties and to reduce our basis risk position. These swaps had been accounted for as fair value hedges. We received proceeds of \$7.2 million in 2009 and \$64.8 million in 2008 as a result of the hedge contract terminations, which are reflected under operating activities in the consolidated statements of cash flows. The proceeds are being amortized over the remaining life of the fixed-rate debt that was hedged by these contracts. We also terminated interest rate swaps with customers and offsetting dealer counterparties totaling notional value of \$260.0 million, \$284.0 million and \$629.0 million in 2010, 2009 and 2008, respectively. Proceeds from the customer terminations were offset by proceeds from the offsetting dealer terminations.

A summary of the impact of derivative financial instruments on our consolidated balance sheet as of December 31, 2010 and 2009 is shown below.

| Fair Value of Derivative Financial Instruments | | | |
|--|-----------------------|----------------------------|---------------|
| | Fair Value of | | Fair Value of |
| As of December 31, 2010 | Derivative | Derivative | Derivative |
| | Assets ⁽¹⁾ | Liabilities ⁽²⁾ | |
| Derivatives Designated as Hedging Instruments | | | |
| Interest Rate Contracts | \$ 917,346 | \$ 19,017 | |
| Foreign Exchange Contracts | 566 | 1,838 | |
| Total Derivatives Designated as Hedging Instruments | \$ 917,912 | \$ 20,855 | |
| Derivatives Not Designated as Hedging Instruments | | | |
| Interest Rate Contracts | \$ 80,433 | \$ 68,913 | |
| Foreign Exchange Contracts | 3,020 | 2,812 | |
| Total Derivatives Not Designated as Hedging Instruments | \$ 83,453 | \$ 71,725 | |
| Total Derivatives | \$ 1,001,365 | \$ 92,580 | |

⁽¹⁾ These assets make up the "Interest Rate Swaps and Other Financial Instruments" assets in the consolidated balance sheet as of December 31, 2010

⁽²⁾ These liabilities make up the "Interest Rate Swaps and Other Financial Instruments" liabilities in the consolidated balance sheet as of December 31, 2010

| Fair Value of Derivative Financial Instruments | | | |
|--|-----------------------|----------------------------|---------------|
| | Fair Value of | | Fair Value of |
| As of December 31, 2009 | Derivative | Derivative | Derivative |
| | Assets ⁽¹⁾ | Liabilities ⁽²⁾ | |
| Derivatives Designated as Hedging Instruments | | | |
| Interest Rate Contracts | \$ 902,717 | \$ 55,364 | |
| Foreign Exchange Contracts | 2,229 | 108 | |
| Total Derivatives Designated as Hedging Instruments | \$ 904,946 | \$ 55,472 | |
| Derivatives Not Designated as Hedging Instruments | | | |
| Interest Rate Contracts | \$ 78,303 | \$ 67,319 | |
| Foreign Exchange Contracts | 825 | 588 | |
| Total Derivatives Not Designated as Hedging Instruments | \$ 79,128 | \$ 67,907 | |
| Total Derivatives | \$ 984,074 | \$ 123,379 | |

⁽¹⁾ These assets make up the "Interest Rate Swaps and Other Financial Instruments" assets in the consolidated balance sheet as of December 31, 2009

⁽²⁾ These liabilities make up the "Interest Rate Swaps and Other Financial Instruments" liabilities in the consolidated balance sheet as of December 31, 2009

A summary of the impact of derivative financial instruments on our consolidated income statement for the years ended December 31, 2010 and 2009 is shown below.

| Derivative Financial Instruments in Fair Value Hedging Relationships | | | |
|---|--|-----------|--------------|
| | Net Amount of Gain or (Loss) Recognized in Income on Derivative and Hedged Item ⁽¹⁾ | | |
| Year Ended December 31, | 2010 | 2009 | |
| Interest Rate Contracts | \$ 2,151 | \$ | 8,347 |
| Total | \$ 2,151 | \$ | 8,347 |

⁽¹⁾ Located in Interest Expense in the consolidated income statements for the years ended December 31, 2010 and 2009

| Derivative Financial Instruments in Cash Flow Hedging Relationships | | | | |
|--|---|---|--|----------------------|
| Year Ended December 31, 2010 | Amount of Gain or (Loss) Recognized in OCI on Derivative ⁽¹⁾ | Amount of Gain or (Loss) Reclassified from OCI to Income on Derivative ⁽¹⁾ | Amount of Gain or (Loss) Recognized in Income on Derivative ⁽²⁾ | |
| Interest Rate | | | | |
| Contracts | \$ (7,171) | \$ (1,311) ⁽³⁾ | \$ | - |
| Foreign Exchange | | | | |
| Contracts | (3,393) | (2,974) ⁽⁴⁾⁽⁵⁾ | | (459) ⁽⁴⁾ |
| Total | \$ (10,564) | \$ (4,285) | \$ | (459) |

⁽¹⁾ Effective portion

⁽²⁾ Ineffective portion and amount excluded from effectiveness assessment

⁽³⁾ Located in Interest Expense in the consolidated income statement for the year ended December 31, 2010

⁽⁴⁾ Located in Interest Income – Loans in the consolidated income statement for the year ended December 31, 2010

⁽⁵⁾ Fully offset by a \$2,974 gain on foreign currency denominated loans (hedged items) which is also located in Interest Income - Loans in the consolidated income statement for the year ended December 31, 2010

Note 12 – Disclosure About Estimated Fair Value of Financial Instruments

Derivative Financial Instruments in Cash Flow Hedging Relationships

| Year Ended December 31, 2009 | Amount of Gain or (Loss) Recognized in OCI on Derivative ⁽¹⁾ | Amount of Gain or (Loss) Reclassified from OCI to Income on Derivative ⁽¹⁾ | Amount of Gain or (Loss) Recognized in Income on Derivative ⁽²⁾ |
|---------------------------------|---|--|--|
| Interest Rate Contracts | \$ 1,680 | \$ (698) ⁽³⁾ | \$ - |
| Foreign Exchange Contracts | 6,384 | 8,028 ^{(4) (5)} | (800) ⁽⁴⁾ |
| Total | \$ 8,064 | \$ 7,330 | \$ (800) |

⁽¹⁾ Effective portion

⁽²⁾ Ineffective portion and amount excluded from effectiveness assessment

⁽³⁾ Located in Interest Expense in the consolidated income statement for the year ended December 31, 2009

⁽⁴⁾ Located in Interest Income – Loans in the consolidated income statement for the year ended December 31, 2009

⁽⁵⁾ Fully offset by an \$8,028 loss on foreign currency denominated loans (hedged items) which is also located in Interest Income - Loans in the consolidated income statement for the year ended December 31, 2009

Derivative Financial Instruments not Designated as Hedging Relationships

| Year Ended December 31, | Net Amount of Gain or (Loss) Recognized in Income On Derivative ⁽¹⁾ | |
|----------------------------|---|-----------------|
| | 2010 | 2009 |
| Interest Rate Contracts | \$ 537 | \$ 1,997 |
| Foreign Exchange Contracts | (29) | (33) |
| Total | \$ 508 | \$ 1,964 |

⁽¹⁾ Located in Other Noninterest Income / Expense in the consolidated income statements for the years ended December 31, 2010 and 2009

The fair values of financial instruments represent the estimated amount to be received to sell an asset or paid to transfer or extinguish a liability (an exit price) in active markets among willing participants at the reporting date. The FASB has established a three-level fair value hierarchy aimed at maximizing the use of observable inputs – that is, inputs that reflect the assumptions market participants would use in pricing an asset or liability. Observable inputs reflect the assumptions market participants would use in pricing an asset or liability based on market data obtained from sources independent of the reporting entity. Unobservable inputs are supported by limited or no market activity and require significant management judgment or estimation.

Due to the uncertainty of expected cash flows resulting from financial instruments, the use of different assumptions and valuation methodologies could significantly affect the estimated fair value amounts. Accordingly, certain estimated fair values may not be indicative of the amounts for which the financial instruments could be exchanged in a current or future market transaction.

A description of the methods, assumptions and inputs to the valuation process used to determine or estimate the fair value of each class of financial instruments within the three-level hierarchy follows.

Level 1

Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Our Level 1 assets at December 31, 2010 consist of assets held in a trust fund related to deferred compensation and our SERP and ERP. The trust fund includes investments in securities that are actively traded and have quoted net asset value prices that are directly observable in the marketplace.

Level 2

Level 2 inputs include quoted prices for similar assets and liabilities in active markets; quoted prices in markets that are not active; and inputs that are observable, or can be corroborated, for substantially the full term of the asset or liability. Our Level 2 assets and liabilities at December 31, 2010 include our derivative contracts, collateral balances related to derivative contracts, and investment securities, excluding asset-backed securities.

The fair value of our derivative financial instruments is the estimated amount to be received to sell a derivative asset or paid to transfer or extinguish a derivative liability in active markets among willing participants at the reporting date. Estimated fair values are determined through internal market valuation models. These models use an income approach and incorporate benchmark interest rate curves (primarily the USD LIBOR/swap curve), volatilities, counterparty credit quality and other inputs that are observable directly or indirectly in the marketplace. We compare internally calculated derivative valuations to broker/dealer quotes to substantiate the results. The fair value of collateral assets and liabilities related to derivative contracts is their face value, plus accrued interest, as these instruments are cash balances; therefore, fair value approximates face value.

The fair value of the majority of our investment securities is determined by a third-party pricing service that uses valuation models to estimate current market prices. Inputs and assumptions related to these models are typically observable in the marketplace. Such models incorporate prepayment assumptions and underlying collateral information to generate cash flows that are discounted using appropriate benchmark interest rate curves and volatilities. These third-party valuation models also incorporate information regarding broker/dealer quotes, available trade information, historical cash flows, credit ratings, and other market information. Such valuations represent an estimated exit price, or price to be received by a seller in active markets to sell the investment securities to a willing participant. The estimated fair values of investment securities also appear in Note 4.

Level 3

Level 3 inputs are unobservable and supported by limited or no market activity. Our Level 3 assets at December 31, 2010 include our asset-backed investment securities which are not issued or guaranteed by the U.S. government or its agencies. Based on the lack of active trading volume and an orderly market for asset-backed securities, we classified this portfolio as Level 3. Market values for such asset-backed securities are calculated internally using third-party models, with certain adjustments made in consideration of third-party pricing service results. Inputs into these valuation models include underlying collateral data and projected losses as well as information for prepayment speeds and discounting spreads. Due to the lack of marketplace information, the inputs into these valuation models primarily represent management assumptions, with some corroboration to observable market inputs.

Level 3 assets at December 31, 2010 also include \$42.3 million of loans originally measured at cost, which were written down to fair value as a result of impairment, and \$7.4 million of other property owned. The valuation of these assets requires a determination of the fair value of the underlying collateral, which may include the use of independent appraisals or other market-based information to develop a management estimate of fair value. As a result, these fair value measurements fall under Level 3 in the fair value hierarchy; however, they are excluded from the following tables because they are not measured on a recurring basis.

Our Level 3 liabilities at December 31, 2010 include standby letters of credit whose market value is internally calculated based on information that is not observable either directly or indirectly in the marketplace.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables present the assets and liabilities that are measured at fair value on a recurring basis at December 31, 2010, 2009 and 2008 for each of the fair value hierarchy levels.

| Assets and Liabilities Measured at Fair Value on a Recurring Basis | | | | |
|---|--------------|------------------|---------------|------------------|
| December 31, 2010 | | | | |
| (\$ in Millions) | Level 1 | Level 2 | Level 3 | Total |
| Assets | | | | |
| Investment Securities: | | | | |
| U.S. Treasury Debt | \$ - | \$ 854 | \$ - | \$ 854 |
| U.S. Agency Debt | - | 2,504 | - | 2,504 |
| U.S. Agency Mortgage-Backed | - | 8,739 | - | 8,739 |
| Non-Agency Mortgage-Backed | - | 402 | - | 402 |
| Asset-Backed | - | - | 118 | 118 |
| Interest Rate Swaps and Other Financial Instruments | - | 1,001 | - | 1,001 |
| Assets Held in Trust (included in Other Assets) | 34 | - | - | 34 |
| Collateral Assets (included in Other Assets) | - | 7 | - | 7 |
| Total Assets | \$ 34 | \$ 13,507 | \$ 118 | \$ 13,659 |
| Liabilities | | | | |
| Interest Rate Swaps and Other Financial Instruments | \$ - | \$ 93 | \$ - | \$ 93 |
| Collateral Liabilities (included in Bonds and Notes) | - | 891 | - | 891 |
| Standby Letters of Credit (included in Other Liabilities) | - | - | 11 | 11 |
| Total Liabilities | \$ - | \$ 984 | \$ 11 | \$ 995 |

The following table presents the changes in Level 3 assets and liabilities measured at fair value on a recurring basis:

Assets and Liabilities Measured at Fair Value on a Recurring Basis

December 31, 2009

| (\$ in Millions) | Level 1 | Level 2 | Level 3 | Total |
|---------------------------------|--------------|------------------|---------------|------------------|
| Assets | | | | |
| Investment Securities: | | | | |
| U.S. Treasury Debt | \$ - | \$ 847 | \$ - | \$ 847 |
| U.S. Agency Debt | - | 2,474 | - | 2,474 |
| U.S. Agency | | | | |
| Mortgage-Backed | - | 7,740 | - | 7,740 |
| Non-Agency | | | | |
| Mortgage-Backed | - | 574 | - | 574 |
| Asset-Backed | - | - | 173 | 173 |
| Federal Funds Sold, Securities | | | | |
| Purchased Under Resale | | | | |
| Agreements and Other | - | 5 | - | 5 |
| Interest Rate Swaps and | | | | |
| Other Financial Instruments | - | 984 | - | 984 |
| Assets Held in Trust | | | | |
| (included in Other Assets) | 32 | - | - | 32 |
| Total Assets | \$ 32 | \$ 12,624 | \$ 173 | \$ 12,829 |
| Liabilities | | | | |
| Interest Rate Swaps and | | | | |
| Other Financial Instruments | \$ - | \$ 123 | \$ - | \$ 123 |
| Collateral Liabilities | | | | |
| (included in Bonds and Notes) | - | 914 | - | 914 |
| Standby Letters of Credit | | | | |
| (included in Other Liabilities) | - | - | 10 | 10 |
| Total Liabilities | \$ - | \$ 1,037 | \$ 10 | \$ 1,047 |

Assets and Liabilities Measured at Fair Value on a Recurring Basis

December 31, 2008

| (\$ in Millions) | Level 1 | Level 2 | Level 3 | Total |
|--------------------------------|--------------|------------------|---------------|------------------|
| Assets | | | | |
| Investment Securities | \$ - | \$ 11,221 | \$ 316 | \$ 11,537 |
| Federal Funds Sold, Securities | | | | |
| Purchased Under Resale | | | | |
| Agreements and Other | - | 5 | - | 5 |
| Interest Rate Swaps and | | | | |
| Other Financial Instruments | - | 1,675 | - | 1,675 |
| Assets Held in Trust | | | | |
| (included in Other Assets) | 26 | - | - | 26 |
| Total Assets | \$ 26 | \$ 12,901 | \$ 316 | \$ 13,243 |
| Liabilities | | | | |
| Interest Rate Swaps and | | | | |
| Other Financial Instruments | \$ - | \$ 134 | \$ 7 | \$ 141 |
| Collateral Liabilities | | | | |
| (included in Bonds and Notes) | - | 1,157 | - | 1,157 |
| Total Liabilities | \$ - | \$ 1,291 | \$ 7 | \$ 1,298 |

Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis

| (\$ in Millions) | Asset-Backed Investment Securities | Standby Letters of Credit |
|--|------------------------------------|---------------------------|
| Balance at January 1, 2008 | \$ 380 | \$ 5 |
| Total Gains or Losses (Realized/Unrealized): | | |
| Included in Other | | |
| Noninterest Expense | (6) | - |
| Included in Other Comprehensive Loss | 5 | - |
| Purchases, Sales, Issuances and Settlements, Net | | |
| | (63) | 2 |
| Balance at December 31, 2008 | \$ 316 | \$ 7 |
| Total Gains or Losses (Realized/Unrealized): | | |
| Included in Other | | |
| Noninterest Expense | (11) | - |
| Included in Other Comprehensive Loss | (30) | - |
| Purchases, Sales, Issuances and Settlements, Net | | |
| | (92) | 3 |
| Transfers into Level 2 | | |
| | (10) | - |
| Balance at December 31, 2009 | \$ 173 | \$ 10 |
| Total Gains or Losses (Realized/Unrealized): | | |
| Included in Other | | |
| Noninterest Expense | (35) | - |
| Included in Other Comprehensive Loss | 27 | 1 |
| Purchases, Sales, Issuances and Settlements, Net | | |
| | (47) | - |
| Balance at December 31, 2010 | \$ 118 | \$ 11 |

Estimated Fair Value of Financial Instruments

The following table presents the estimated fair values of financial instruments that are recorded in the consolidated balance sheets at cost, as well as certain off-balance sheet financial instruments, as of December 31, 2010, 2009 and 2008.

| Estimated Fair Value of Financial Instruments | | | | | | |
|---|-----------------|----------------------|-----------------|----------------------|-----------------|----------------------|
| December 31, | 2010 | | 2009 | | 2008 | |
| (\$ in Millions) | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Financial Assets: | | | | | | |
| Net Loans | \$ 49,592 | \$ 50,613 | \$ 43,805 | \$ 44,337 | \$ 44,221 | \$ 44,551 |
| Financial Liabilities: | | | | | | |
| Bonds and Notes | \$ 59,324 | \$ 60,094 | \$ 51,911 | \$ 52,493 | \$ 55,365 | \$ 55,874 |
| Subordinated Debt | 1,000 | 953 | 1,000 | 877 | 1,000 | 787 |
| Off-Balance Sheet Financial Instruments: | | | | | | |
| Commitments to Extend Credit | \$ - | \$ (80) | \$ - | \$ (72) | \$ - | \$ (54) |

Net Loans

Our loan portfolio includes fixed- and floating-rate loans. Since no active trading market exists for most of our loans, fair value is estimated by discounting the expected future cash flows using current interest rates at which similar loans would be made to borrowers with similar credit risk.

Bonds and Notes

Bonds and notes are not all regularly traded in the secondary market and those that are traded may not have readily available quoted market prices. To the extent that quoted market prices are not readily available, the fair value of these instruments is estimated by discounting expected future cash flows based on the quoted market price of similar maturity U.S. Treasury notes, assuming a constant estimated yield spread relationship between Systemwide Debt Securities and comparable U.S. Treasury notes.

Subordinated Debt

The fair value of subordinated debt is estimated based upon quotes obtained from a broker/dealer.

Commitments to Extend Credit

The fair value of commitments is estimated by applying a risk-adjusted spread percentage to these obligations.

Note 13 – Related Party Transactions

In the ordinary course of business, we enter into loan transactions with customers, the officers or directors of which may also serve on our Board of Directors. Such loans are subject to special review and reporting requirements contained in the FCA regulations, are reviewed and approved only at the most senior loan committee level within the Bank and are reported to the Board of Directors. Except as noted below, all related party loans are made in accordance with established policies on substantially the same terms, including interest rates and collateral requirements, as those prevailing at the time for comparable transactions with unrelated borrowers.

During 2010, we made a \$4.0 million loan to Dixie Electric Membership Corporation (DEMCO), with which Richard W. Sitman, a member of our Board of Directors, is affiliated. The loan was made to refinance a portion of DEMCO's existing long-term indebtedness. CoBank's pricing policy was unintentionally misapplied to this loan and the loan was closed with an interest rate of 3.25 percent, which is lower than rates on similar loans to unrelated borrowers. As of December 31, 2010, there was \$3.9 million outstanding on this loan, which is less than 10 percent of the Bank's total exposure to DEMCO.

Total direct loans outstanding to customers whose officers or directors serve on our Board of Directors amounted to \$561.5 million at December 31, 2010. During 2010, \$3.1 billion of new loans were made and repayments totaled \$2.9 billion. None of these loans outstanding at December 31, 2010 were delinquent, in nonaccrual or accruing restructured status or, in the opinion of management, involved more than a normal risk of collectibility.

Note 14 – Segment Financial Information

We conduct our lending operations through three operating segments: Agribusiness, Strategic Relationships and Rural Infrastructure.

The following table presents condensed disaggregated information for the segments. Allocations of resources and corporate items, as well as measurement of financial performance, are made at these operating segment levels. We also allocate to our segments net interest income on investment securities, federal funds sold, securities purchased under resale agreements and other highly-liquid assets. Information to reconcile the total reportable segments to the total CoBank financial statements is shown as “other.”

Intersegment transactions are insignificant. Financial results presented for the prior periods have been reclassified to conform to our current year presentation.

We do not hold significant assets in any foreign country. Substantially all of our international loans are U.S dollar-denominated and the majority of these loans are guaranteed by a U.S. government-sponsored loan guarantee program. For each of the years ended December 31, 2010, 2009 and 2008, interest earned from an affiliated Association, Northwest, represented 10 percent of our gross interest income and less than 10 percent of our net interest income. No other customer made up 10 percent or more of our gross or net interest income for the periods presented.

Segment Financial Information

| | Strategic Agribusiness | Strategic Relationships | Rural Infrastructure | Subtotal | Other | Total CoBank |
|---|---------------------------|----------------------------|-------------------------|-------------------|--------------------|-------------------|
| 2010 Results of Operations (\$ in Thousands): | | | | | | |
| Net Interest Income | \$ 547,102 | \$ 93,071 | \$ 315,645 | \$ 955,818 | \$ (4,973) | \$ 950,845 |
| Provision for Loan Losses | 7,167 | - | 52,833 | 60,000 | - | 60,000 |
| Noninterest Income | 57,336 | 801 | 41,816 | 99,953 | (1,394) | 98,559 |
| Operating Expenses | 117,798 | 13,426 | 81,877 | 213,101 | 3,109 | 216,210 |
| Provision for Income Taxes | 114,226 | - | 47,155 | 161,381 | (1,954) | 159,427 |
| Net Income | \$ 365,247 | \$ 80,446 | \$ 175,596 | \$ 621,289 | \$ (7,522) | \$ 613,767 |
| 2010 Selected Financial Information at December 31, 2010 (\$ in Millions): | | | | | | |
| Loans | \$ 22,676 | \$ 15,392 | \$ 11,924 | \$ 49,992 | \$ - | \$ 49,992 |
| Less: Allowance for Loan Losses | (284) | - | (116) | (400) | - | (400) |
| Net Loans | \$ 22,392 | \$ 15,392 | \$ 11,808 | \$ 49,592 | \$ - | \$ 49,592 |
| Total Assets | \$ 22,513 | \$ 15,439 | \$ 11,869 | \$ 49,821 | \$ 16,005 * | \$ 65,826 |
| *Other assets are comprised of: | | | | | | |
| Investment Securities | | | | | | \$ 12,617 |
| Other Assets | | | | | | 3,388 |
| 2009 Results of Operations (\$ in Thousands): | | | | | | |
| Net Interest Income | \$ 518,376 | \$ 113,548 | \$ 317,064 | \$ 948,988 | \$ (3,025) | \$ 945,963 |
| Provision for Loan Losses | 39,000 | - | 41,000 | 80,000 | - | 80,000 |
| Noninterest Income | 61,301 | 972 | 25,065 | 87,338 | (2,377) | 84,961 |
| Operating Expenses | 135,346 | 17,556 | 65,777 | 218,679 | 552 | 219,231 |
| Provision for Income Taxes | 116,798 | - | 50,875 | 167,673 | (1,396) | 166,277 |
| Net Income | \$ 288,533 | \$ 96,964 | \$ 184,477 | \$ 569,974 | \$ (4,558) | \$ 565,416 |
| 2009 Selected Financial Information at December 31, 2009 (\$ in Millions): | | | | | | |
| Loans | \$ 17,469 | \$ 15,271 | \$ 11,434 | \$ 44,174 | \$ - | \$ 44,174 |
| Less: Allowance for Loan Losses | (265) | - | (105) | (370) | - | (370) |
| Net Loans | \$ 17,204 | \$ 15,271 | \$ 11,329 | \$ 43,804 | \$ - | \$ 43,804 |
| Total Assets | \$ 17,287 | \$ 15,316 | \$ 11,383 | \$ 43,986 | \$ 14,175 * | \$ 58,161 |
| *Other assets are comprised of: | | | | | | |
| Investment Securities | | | | | | \$ 11,808 |
| Federal Funds Sold, Securities Purchased Under Resale Agreements and Other | | | | | | 5 |
| Other Assets | | | | | | 2,362 |
| 2008 Results of Operations (\$ in Thousands): | | | | | | |
| Net Interest Income | \$ 556,284 | \$ 79,422 | \$ 228,303 | \$ 864,009 | \$ (1,400) | \$ 862,609 |
| Provision (Reversal) for Loan Losses | 70,000 | - | (15,000) | 55,000 | - | 55,000 |
| Noninterest Income | 46,361 | 1,198 | 21,698 | 69,257 | (846) | 68,411 |
| Operating Expenses | 140,259 | 12,774 | 56,385 | 209,418 | 5,763 | 215,181 |
| Provision for Income Taxes | 85,907 | - | 43,006 | 128,913 | (1,507) | 127,406 |
| Net Income | \$ 306,479 | \$ 67,846 | \$ 165,610 | \$ 539,935 | \$ (6,502) | \$ 533,433 |
| 2008 Selected Financial Information at December 31, 2008 (\$ in Millions): | | | | | | |
| Loans | \$ 18,498 | \$ 15,026 | \$ 11,026 | \$ 44,550 | \$ - | \$ 44,550 |
| Less: Allowance for Loan Losses | (231) | - | (98) | (329) | - | (329) |
| Net Loans | \$ 18,267 | \$ 15,026 | \$ 10,928 | \$ 44,221 | \$ - | \$ 44,221 |
| Total Assets | \$ 18,425 | \$ 15,099 | \$ 10,988 | \$ 44,512 | \$ 16,650 * | \$ 61,162 |
| *Other assets are comprised of: | | | | | | |
| Investment Securities | | | | | | \$ 11,537 |
| Federal Funds Sold, Securities Purchased Under Resale Agreements and Other | | | | | | 5 |
| Other Assets | | | | | | 5,108 |

Note 15 – Commitments and Contingent Liabilities

At December 31, 2010, various lawsuits were pending or threatened against the Bank in which claims for monetary damages have been or may be asserted. In the opinion of management, based on information currently available and taking into account the advice of legal counsel, the ultimate liability, if any, of pending or threatened legal actions will not have a material adverse impact on our results of operations or financial position.

We have entered into employment agreements with two of our senior officers which will provide specified payments, as well as certain enhanced retirement benefits, in the event of a termination, except in the case of a termination for cause. These employment agreements also provide for enhanced payments in the event of a change in control.

We have various commitments outstanding and contingent liabilities as discussed elsewhere in these notes to consolidated financial statements. Under the Farm Credit Act of 1971, as amended, CoBank is primarily liable for its portion of Systemwide Debt Securities. Additionally, we are contingently liable for the Systemwide Debt Securities of the other System banks. Total Systemwide Debt Securities of the System were \$188.8 billion at December 31, 2010.

There are several mechanisms in place affecting exposure to statutory joint and several liabilities. These mechanisms include:

- The statutory requirement for System banks to maintain eligible assets at a level at least equal in value to the total amount of debt for which such System bank is primarily liable;
- The Insurance Fund, a statutorily created fund to assist in the timely payment of principal and interest on Systemwide Debt Securities in the event of a default by a System bank to the extent that net assets are available in the Insurance Fund. At December 31, 2010, the assets of the Insurance Fund aggregated \$3.2 billion; and
- Maintenance of certain financial criteria by agreements which, if not met, could limit or ultimately deny a troubled System bank's access to and participation in System debt issuances.

Note 16 – Quarterly Financial Information

Unaudited quarterly results of operations for the years ended December 31, 2010, 2009 and 2008, are shown in the table below.

| Quarterly Financial Information (Unaudited) | | | | | | |
|---|-------------------|-------------------|-------------------|-------------------|-------------------|--|
| 2010 | First | Second | Third | Fourth | Total | |
| Net Interest Income | \$ 230,720 | \$ 217,903 | \$ 226,276 | \$ 275,946 | \$ 950,845 | |
| Provision for Loan Losses | 12,500 | 4,000 | 21,000 | 22,500 | 60,000 | |
| Noninterest Income and Expenses, Net | 8,018 | 26,688 | 39,979 | 42,966 | 117,651 | |
| Provision for Income Taxes | 41,543 | 36,843 | 33,339 | 47,702 | 159,427 | |
| Net Income | \$ 168,659 | \$ 150,372 | \$ 131,958 | \$ 162,778 | \$ 613,767 | |
| 2009 | First | Second | Third | Fourth | Total | |
| Net Interest Income | \$ 253,258 | \$ 239,679 | \$ 223,108 | \$ 229,918 | \$ 945,963 | |
| Provision for Loan Losses | 20,000 | 10,000 | 25,000 | 25,000 | 80,000 | |
| Noninterest Income and Expenses, Net | 28,237 | 32,299 | 45,631 | 28,103 | 134,270 | |
| Provision for Income Taxes | 45,164 | 41,243 | 35,704 | 44,166 | 166,277 | |
| Net Income | \$ 159,857 | \$ 156,137 | \$ 116,773 | \$ 132,649 | \$ 565,416 | |
| 2008 | First | Second | Third | Fourth | Total | |
| Net Interest Income | \$ 217,693 | \$ 231,736 | \$ 222,494 | \$ 190,686 | \$ 862,609 | |
| Provision for Loan Losses | - | - | - | 55,000 | 55,000 | |
| Noninterest Income and Expenses, Net | 28,372 | 34,663 | 43,211 | 40,524 | 146,770 | |
| Provision for Income Taxes | 39,761 | 38,690 | 38,400 | 10,555 | 127,406 | |
| Net Income | \$ 149,560 | \$ 158,383 | \$ 140,883 | \$ 84,607 | \$ 533,433 | |

Note 17 – Affiliated Agricultural Credit Associations

We are chartered by the FCA to serve the Associations that provide credit and financially related services to or for the benefit of eligible borrowers/shareholders for qualified purposes primarily doing business in the New England states, New York, New Jersey, Alaska, Idaho, Montana, Oregon and Washington. The Associations are statutorily precluded by the Farm Credit Act from participating in the issuance of Systemwide Debt Securities. Therefore, we are the primary funding source for our affiliated Associations. The Associations primarily originate and service short- and intermediate-term loans for agricultural purposes and secured long-term real estate mortgage loans. The Associations may also purchase eligible loan participations from System entities and other lending institutions. Additionally, the Associations serve as an intermediary in offering credit life insurance and multi-peril crop insurance and providing additional financial services to borrowers.

The Farm Credit Act and FCA regulations require us to exercise limited supervision over the operating activities of our affiliated Associations. These Associations and CoBank operate under a debtor-creditor relationship evidenced by a General Financing Agreement (GFA) entered into separately with each Association. The GFA sets forth the business relationship between us and each Association and also references certain requirements contained in the Farm Credit Act and FCA regulations. The Associations' boards of directors are expected to establish and monitor the necessary policies and procedures to comply with all FCA regulations. In all other respects, the lending relationship with the Associations is substantially similar to that with our other borrowers.

The FCA's capital adequacy regulations require all System institutions to individually maintain permanent capital of 7 percent of average risk-adjusted assets. At December 31, 2010, the permanent capital ratios of our affiliated Associations exceeded these standards.

We make loans to the Associations, which, in turn, make loans to their eligible borrowers. We have senior secured interests in substantially all of the Associations' assets, which extend to the underlying collateral of the Associations' loans to their customers. The loans outstanding to our affiliated Associations amounted to \$11.4 billion at December 31, 2010. During 2010, \$33.1 billion of new loans were made to our affiliated Associations and repayments totaled \$32.9 billion.

We have only limited access to Association capital. Our bylaws permit our Board of Directors to set the target equity level for Association investment in the Bank within a range of 4 to 6 percent of the one-year historical average of Association borrowings. In 2010, the required investment level was 4 percent. There is no capital sharing agreement between us and our affiliated Associations.

Supplemental District Financial Information

CoBank, ACB and Affiliated Associations

Our affiliated Associations operate independently and maintain an arms-length relationship with us, except to the limited extent that the Farm Credit Act requires us, as the funding bank, to monitor and approve certain activities of affiliated Associations. Accordingly, the financial information of affiliated Associations is not included in our audited consolidated financial statements. However, because of the interdependent manner in which CoBank and its affiliated Associations operate, we believe that presenting combined Bank and Association financial information is meaningful for purposes of additional analysis.

The Combining Balance Sheets and Income Statements, ratios and other financial information on pages 101 to 103, present condensed combined financial information of CoBank and its affiliated Associations, which are collectively referred to as the District. As part of the combining process, all significant transactions between CoBank and its affiliated Associations, including loans made by the Bank to the affiliated Associations and the interest income/interest expense related thereto, and investments of the affiliated Associations in the Bank and the earnings related thereto, have been eliminated.

District Financial Condition and Results of Operations

Districtwide assets grew by 13 percent in 2010, as compared to a decline of 5 percent in 2009, largely due to the increase in period-end loan volume at the Bank. Period-end assets for the combined Associations grew 2 percent in 2010 compared to 3 percent in 2009. The modest rate of growth at the Associations in 2010 and 2009 reflected weak loan demand at the producer level of the U.S. farm economy.

At the end of 2010, combined District shareholders' equity was \$6.2 billion and capital levels at all District entities were well in excess of minimum regulatory capital requirements.

District net income increased to \$818 million in 2010 from \$704 million for 2009. The combined net income of the Associations increased 31 percent to \$263 million in 2010. This increase was primarily the result of an improvement in net interest income, a lower combined provision for loan losses, increased noninterest income and lower operating expenses.

District net interest income increased by \$30 million in 2010. Net interest income for our combined affiliated Associations increased by \$25 million in 2010, as lending spreads widened to match current market conditions.

The District's provision for loan losses decreased to \$146 million in 2010 from \$183 million in 2009. The Associations' combined provision for loan losses decreased to \$86 million for 2010 compared to \$103 million in 2009, driven by a lower level of provisions at our largest affiliated Association. Notwithstanding the lower level of provisions in 2010, ongoing credit challenges in the dairy, timber and nursery industries could lead to a decline in the Associations' credit quality and an increase in provisions for loan losses.

District noninterest income totaled \$166 million in 2010 compared to \$135 million in 2009. Noninterest income at the Associations increased by \$14 million largely due to refunds of a portion of Farm Credit insurance fund premiums paid in prior years.

District operating expenses decreased to \$393 million, or 3 percent, in 2010 from \$407 million for 2009. Operating expenses at our combined affiliated Associations decreased by \$11 million, primarily due to the decrease in Insurance Fund premiums.

Supplemental District Financial Information

CoBank, ACB and Affiliated Associations

Combining Balance Sheets (Condensed)

(\$ in Millions) (Unaudited)

| As of December 31, 2010 | CoBank | Combined Affiliated Associations | Eliminations | Combined District |
|---|------------------|--|--------------------|----------------------|
| Investments, Federal Funds Sold, Securities Purchased | | | | |
| Under Resale Agreements and Other | \$ 12,617 | \$ - | \$ - | 12,617 |
| Loans | 49,992 | 13,149 | (11,327) | 51,814 |
| Less: Allowance for Loan Losses | (400) | (176) | - | (576) |
| Net Loans | 49,592 | 12,973 | (11,327) | 51,238 |
| Other Assets | 3,617 | 810 | (582) | 3,845 |
| Total Assets | \$ 65,826 | \$ 13,783 | \$ (11,909) | \$ 67,700 |
| Bonds and Notes | \$ 60,324 | \$ 11,403 | \$ (11,364) | \$ 60,363 |
| Reserve for Unfunded Commitments | 100 | 7 | - | 107 |
| Other Liabilities | 996 | 148 | (68) | 1,076 |
| Total Liabilities | 61,420 | 11,558 | (11,432) | 61,546 |
| Total Shareholders' Equity | 4,406 | 2,225 | (477) | 6,154 |
| Total Liabilities and Shareholders' Equity | \$ 65,826 | \$ 13,783 | \$ (11,909) | \$ 67,700 |

| As of December 31, 2009 | CoBank | Combined Affiliated Associations | Eliminations | Combined District |
|---|------------------|--|--------------------|----------------------|
| Investments, Federal Funds Sold, Securities Purchased | | | | |
| Under Resale Agreements and Other | \$ 11,813 | \$ - | \$ - | 11,813 |
| Loans | 44,174 | 12,805 | (11,196) | 45,783 |
| Less: Allowance for Loan Losses | (370) | (151) | - | (521) |
| Net Loans | 43,804 | 12,654 | (11,196) | 45,262 |
| Other Assets | 2,544 | 819 | (595) | 2,768 |
| Total Assets | \$ 58,161 | \$ 13,473 | \$ (11,791) | \$ 59,843 |
| Bonds and Notes | \$ 52,911 | \$ 11,277 | \$ (11,239) | \$ 52,949 |
| Reserve for Unfunded Commitments | 128 | 7 | - | 135 |
| Other Liabilities | 1,064 | 140 | (80) | 1,124 |
| Total Liabilities | 54,103 | 11,424 | (11,319) | 54,208 |
| Total Shareholders' Equity | 4,058 | 2,049 | (472) | 5,635 |
| Total Liabilities and Shareholders' Equity | \$ 58,161 | \$ 13,473 | \$ (11,791) | \$ 59,843 |

| As of December 31, 2008 | CoBank | Combined Affiliated Associations | Eliminations | Combined District |
|---|------------------|--|--------------------|----------------------|
| Investments, Federal Funds Sold, Securities Purchased | | | | |
| Under Resale Agreements and Other | \$ 11,542 | \$ - | \$ - | 11,542 |
| Loans | 44,550 | 12,401 | (10,879) | 46,072 |
| Less: Allowance for Loan Losses | (329) | (89) | - | (418) |
| Net Loans | 44,221 | 12,312 | (10,879) | 45,654 |
| Other Assets | 5,399 | 754 | (565) | 5,588 |
| Total Assets | \$ 61,162 | \$ 13,066 | \$ (11,444) | \$ 62,784 |
| Bonds and Notes | \$ 56,365 | \$ 11,015 | \$ (10,944) | \$ 56,436 |
| Reserve for Unfunded Commitments | 154 | 7 | - | 161 |
| Other Liabilities | 1,048 | 132 | (72) | 1,108 |
| Total Liabilities | 57,567 | 11,154 | (11,016) | 57,705 |
| Total Shareholders' Equity | 3,595 | 1,912 | (428) | 5,079 |
| Total Liabilities and Shareholders' Equity | \$ 61,162 | \$ 13,066 | \$ (11,444) | \$ 62,784 |

Supplemental District Financial Information

CoBank, ACB and Affiliated Associations

Combining Income Statements (Condensed)

(\$ in Millions) (Unaudited)

| | CoBank | Combined Affiliated Associations | Eliminations | Combined District |
|----------------------------|---------------|--|----------------|----------------------|
| 2010 | | | | |
| Net Interest Income | \$ 951 | \$ 403 | \$ - | \$ 1,354 |
| Provision for Loan Losses | 60 | 86 | - | 146 |
| Noninterest Income | 98 | 127 | (59) | 166 |
| Operating Expenses | 216 | 177 | - | 393 |
| Provision for Income Taxes | 159 | 4 | - | 163 |
| Net Income | \$ 614 | \$ 263 | \$ (59) | \$ 818 |
| 2009 | | | | |
| Net Interest Income | \$ 946 | \$ 378 | \$ - | \$ 1,324 |
| Provision for Loan Losses | 80 | 103 | - | 183 |
| Noninterest Income | 85 | 113 | (63) | 135 |
| Operating Expenses | 220 | 188 | (1) | 407 |
| Provision for Income Taxes | 166 | (1) | - | 165 |
| Net Income | \$ 565 | \$ 201 | \$ (62) | \$ 704 |
| 2008 | | | | |
| Net Interest Income | \$ 863 | \$ 315 | \$ 1 | \$ 1,179 |
| Provision for Loan Losses | 55 | 30 | - | 85 |
| Noninterest Income | 68 | 99 | (49) | 118 |
| Operating Expenses | 215 | 167 | - | 382 |
| Provision for Income Taxes | 128 | 7 | - | 135 |
| Net Income | \$ 533 | \$ 210 | \$ (48) | \$ 695 |

Key Financial Ratios

(Unaudited)

| | 2010 | 2009 | 2008 |
|---|---------|---------|---------|
| Return on Average Assets | 1.33 % | 1.12 % | 1.16 % |
| Return on Average Capital | 13.68 | 12.98 | 14.10 |
| Net Interest Margin | 2.30 | 2.26 | 2.01 |
| Net Charge-offs as a Percent of Average Loans | (0.24) | (0.23) | (0.05) |
| Reserve for Credit Exposure as a Percent of Loans | 1.32 | 1.43 | 1.26 |
| Capital as a Percent of Total Assets | 9.09 | 9.42 | 8.09 |
| Risk Funds as a Percent of Loans | 13.19 | 13.74 | 12.28 |
| Debt to Capital (:1) | 10.00 | 9.62 | 11.36 |
| Operating Expenses as a Percent of Net Interest Income and Noninterest Income | 25.53 % | 27.83 % | 29.45 % |

Loan Quality Ratios

(Unaudited)

| | 2010 | 2009 | 2008 |
|-----------------|-----------------|-----------------|-----------------|
| Acceptable | 91.48 % | 92.29 % | 95.87 % |
| Special Mention | 5.13 | 3.71 | 1.80 |
| Substandard | 3.24 | 3.77 | 2.26 |
| Doubtful | 0.15 | 0.23 | 0.07 |
| Loss | - | - | - |
| Total | 100.00 % | 100.00 % | 100.00 % |

Supplemental District Financial Information

CoBank, ACB and Affiliated Associations

Portfolio Diversification

(Unaudited)

| Distribution by Primary Business / Commodity | 2010 | 2009 | 2008 |
|--|--------------|--------------|--------------|
| Farm Supply, Grain and Marketing | 24 % | 16 % | 16 % |
| Electric Distribution | 10 | 9 | 9 |
| Fruits, Nuts and Vegetables | 8 | 9 | 9 |
| Other Farm Credit Entities | 8 | 9 | 9 |
| International Lending | 8 | 9 | 9 |
| Dairy | 7 | 8 | 7 |
| Livestock, Fish and Poultry | 5 | 6 | 6 |
| Forest Products | 4 | 5 | 6 |
| Generation and Transmission | 5 | 6 | 5 |
| Local Telephone Exchange Carriers | 3 | 4 | 5 |
| Leasing | 3 | 4 | 4 |
| Farm Related Business Services | 3 | 3 | 3 |
| Other | 12 | 12 | 12 |
| Total | 100 % | 100 % | 100 % |

(Unaudited)

| Geographic Distribution | 2010 | 2009 | 2008 |
|---|--------------|--------------|--------------|
| Texas | 10 % | 11 % | 11 % |
| Iowa | 6 | 4 | 4 |
| Washington | 6 | 6 | 6 |
| California | 6 | 7 | 7 |
| New York | 6 | 7 | 7 |
| Oregon | 5 | 5 | 5 |
| Idaho | 4 | 5 | 4 |
| Minnesota | 4 | 3 | 3 |
| Illinois | 4 | 2 | 2 |
| Nebraska | 3 | 2 | 3 |
| Kansas | 3 | 2 | 2 |
| New Jersey | 2 | 2 | 2 |
| Montana | 2 | 2 | 2 |
| Other (less than 2 percent each for the current year) | 31 | 33 | 33 |
| Total States | 92 % | 91 % | 91 % |
| Latin America | 3 | 3 | 4 |
| Europe, Mideast and Africa | 3 | 3 | 3 |
| Other International | 2 | 3 | 2 |
| Total International | 8 % | 9 % | 9 % |
| Total | 100 % | 100 % | 100 % |

Report of Management

CoBank, ACB

March 1, 2011

To our Shareholders:

The consolidated financial statements of CoBank, ACB (CoBank) are prepared by management, which is responsible for their integrity and objectivity, including amounts that must necessarily be based on judgments and estimates. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as appropriate in the circumstances. The consolidated financial statements, in the opinion of management, fairly present, in all material respects, the consolidated financial position of CoBank. Other consolidated financial information included in the Annual Report to Shareholders is consistent with that in the financial statements.

To meet its responsibility for reliable consolidated financial information, management depends on accounting and internal control systems which have been designed to provide reasonable, but not absolute, assurance that assets are safeguarded and transactions are properly authorized and recorded. The systems have been designed to recognize that the cost must be related to the benefits derived. To monitor compliance, CoBank's internal audit staff performs audits of the accounting records, reviews accounting systems and internal controls, and recommends improvements as deemed appropriate. CoBank's 2010, 2009 and 2008 consolidated financial statements have been audited by PricewaterhouseCoopers LLP, independent auditors. In addition, our independent auditors have audited our internal control over financial reporting as of December 31, 2010, 2009 and 2008. CoBank is also examined by the Farm Credit Administration.

The president and chief executive officer, as delegated by the Board of Directors, has overall responsibility for CoBank's system of internal controls and financial reporting, subject to the review of the audit committee of the Board of Directors. The president and chief executive officer reports periodically on those matters to the audit committee. The audit committee consults regularly with management and meets periodically with the independent auditors and internal auditors to review the scope and results of their work. The audit committee reports regularly to the Board of Directors. Both the independent auditors and the internal auditors have direct access to the audit committee, which is composed solely of directors who are not officers or employees of CoBank.

The undersigned certify that this CoBank Annual Report to Shareholders has been reviewed by the undersigned and has been prepared in accordance with all applicable statutory or regulatory requirements and that the information contained herein is true, accurate and complete to the best of their knowledge.

Everett Dobrinski
Chairman of the Board

Robert B. Engel
President and Chief Executive Officer

David P. Burlage
Chief Financial Officer

Report of Independent Auditors

CoBank, ACB

To the Board of Directors and Shareholders of CoBank, ACB:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of changes in shareholders' equity and of cash flows appearing on pages 60 through 64 of the CoBank 2010 Annual Report to Shareholders present fairly, in all material respects, the financial position of CoBank, ACB and its subsidiary (CoBank) at December 31, 2010, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2010 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, CoBank maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). CoBank's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the Report of Management appearing on page 104 of the CoBank 2010 Annual Report to Shareholders. Our responsibility is to express opinions on these consolidated financial statements and on CoBank's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with generally accepted auditing standards established by the Auditing Standards Board (United States) and in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Report of Independent Auditors

CoBank, ACB

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Denver, Colorado
March 1, 2011

Management's Report on Internal Control Over Financial Reporting

CoBank, ACB

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. CoBank's internal control over financial reporting is a process designed under the supervision of our president and chief executive officer and our chief financial officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Bank's financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles. As of the end of the Bank's 2010 fiscal year, management conducted an assessment of the effectiveness of the Bank's internal control over financial reporting based on the framework established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, our management concluded that the Bank's internal control over financial reporting is effective as of December 31, 2010.

Our internal control over financial reporting includes policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and the directors of CoBank; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Bank's assets that could have a material effect on our financial statements.

The effectiveness of the Bank's internal control over financial reporting as of December 31, 2010 has been audited by PricewaterhouseCoopers LLP, independent auditors, as stated in their report appearing on pages 105 and 106, which expresses an unqualified opinion on the effectiveness of the Bank's internal control over financial reporting as of December 31, 2010. There have been no changes in the Bank's internal control over financial reporting that occurred during our most recent fiscal quarter (i.e., the fourth quarter of 2010) that have materially affected, or are reasonably likely to materially affect, the Bank's internal control over financial reporting.

Controls and Procedures

CoBank, ACB

We maintain a system of disclosure controls and procedures. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information disclosed by us in our quarterly and annual reports is accumulated and communicated to our management, including our principal executive officer and our principal financial officer, as appropriate, to allow timely decisions to be made regarding disclosure. The president and chief executive officer and the chief financial officer have evaluated our disclosure controls and procedures as of the end of the period covered by this annual report and have concluded that our disclosure controls and procedures are effective as of that date.

We also maintain a system of internal controls. The term “internal controls,” as defined by the American Institute of Certified Public Accountants’ Codification of Statement on Auditing Standards, AU Section 319, means a process - effected by the board of directors, management and other personnel - designed to provide reasonable assurance regarding the achievement of objectives in reliability of financial reporting, the effectiveness and efficiency of operations and of compliance with applicable laws and regulations. We continually assess the adequacy of our internal controls over financial reporting and enhance our controls in response to internal control assessments and internal and external audit and regulatory recommendations. There have been no significant changes in our internal controls or in other factors that could significantly affect such controls subsequent to the date we carried out our evaluations. In accordance with our internal control procedures, these financial statements were prepared under the oversight of the Audit Committee of our Board of Directors.

Annual Report to Shareholders Disclosure Information Required by Farm Credit Administration Regulations

CoBank, ACB

In accordance with Farm Credit Administration (FCA) regulations, CoBank has prepared this Annual Report to Shareholders for the year ended December 31, 2010, in accordance with all applicable statutory or regulatory requirements.

| | <u>Section</u> | <u>Location</u> |
|---|--|---|
| Description of Business | | |
| Territory served, eligible borrowers, types of lending activities engaged in, financial services offered, and related Farm Credit organizations. | Notes to Financial Statements..... | Note 1 Note 17 |
| Significant developments within the last 5 years that had or could have a material impact on earnings or interest rates to borrowers, acquisitions or dispositions of material assets, material changes in the manner of conducting business, seasonal characteristics, concentration of assets, and dependence, if any, upon a single customer or a few customers. | Notes to Financial Statements..... | Note 1 Note 2 Note 3 Note 4 Note 5 Note 7 Note 13 Note 14 Note 15 Note 16 Note 17 |
| | Management's Discussion and Analysis | Pages 28 to 59 |
| Description of Property | | |
| Location of Property CoBank leases its national office building which is located in Greenwood Village, Colorado. CoBank also leases various facilities which are described on the inside back cover of this Annual Report to Shareholders. CoBank leases banking center offices in Ames, IA; Atlanta, GA; Austin, TX; Enfield, CT; Fargo, ND; Louisville, KY; Lubbock, TX; Minneapolis, MN; Omaha, NE; Sacramento, CA; Spokane, WA; St. Louis, MO; and Wichita, KS. CoBank leases office space in Washington D.C. and Singapore. Farm Credit Leasing Services Corporation leases its headquarters office in Minneapolis, MN, as well as outside sales offices in Atlanta, GA; Enfield, CT; Louisville, KY; Lubbock, TX; Mechanicsburg, PA; Omaha, NE; Sacramento, CA; Salisbury, MD; St. Louis, MO; Statesville, NC; Stockton, CA; and Wichita, KS, some of which are located in CoBank banking centers. | Office Locations..... | Inside Back Cover |
| CoBank has a national charter and, as a result, serves customers across rural America. Travel to customer locations may be difficult due to the rural nature of many of our customer's operations. In order to provide the appropriate level of customer contact and to optimize the efficiency of management travel, CoBank utilizes a variety of transportation in order to serve its customers, including aircraft (both commercial and fractional interest). The use of fractional interest aircraft is strictly limited to business use. | | |
| Legal Proceedings and Enforcement Actions | Notes to Financial Statements..... | Note 15 |
| Description of Capital Structure | Notes to Financial Statements..... | Note 7 |
| Description of Liabilities | | |
| Debt Outstanding | Notes to Financial Statements..... | Notes 5 and 6 |
| Contingent Liabilities | Notes to Financial Statements..... | Note 15 |
| Selected Financial Data for the Five Years Ended December 31, 2010 | Five-Year Summary of Selected Consolidated Financial Data | Page 27 |
| Management's Discussion and Analysis of Financial Condition and Results of Operations | Management's Discussion and Analysis | Pages 28 to 59 |
| Directors and Senior Officers | | |
| Directors' Information | Board of Directors Disclosure | Pages 112 to 118, 132 |
| Senior Officers' Information | Senior Officers | Pages 119 to 131 |
| Transactions with Directors and Senior Officers | Notes to Financial Statements..... | Note 13 |

Annual Report to Shareholders Disclosure Information Required by Farm Credit Administration Regulations CoBank, ACB

| Section | Location |
|---|---|
| Involvement in Certain Legal Proceedings | |
| There were no matters that came to the attention of the Board of Directors or management regarding the involvement of current directors or senior officers in specified legal proceedings which are required to be disclosed. | |
| Relationship with Independent Auditors | |
| There has been no change in independent auditors or no disagreements on any matters of accounting principle or financial statement disclosure during the period. | |
| Financial Statements | |
| Financial Statements and Footnotes | Financial Information..... Pages 60 to 99 |
| Report of Management | Report of Management Page 104 |
| Report of Independent Auditors | Report of Independent Auditors Pages 105 to 106 |
| Aggregate Fees Incurred for Services Rendered by Independent Auditors | Board of Directors Disclosure Page 113 |
| Credit and Services to Young, Beginning and Small Farmers and Ranchers and Producers or Harvesters of Aquatic Products | Young, Beginning and Small Farmers..... Page 134 |

Board of Directors Disclosure as of December 31, 2010

CoBank, ACB

Directors

CoBank's bylaws authorize a Board of Directors consisting of 15 to 17 members. As of December 31, 2010, the Board consisted of 16 directors, as follows: (i) four directors elected from each of our three regions (east, central and west); (ii) two Board-selected outside directors (independent of any customer or Farm Credit System affiliation); and (iii) two Board-appointed (customer affiliation permitted) director positions. Director terms run for four years. Employees of Farm Credit System institutions, including CoBank, cannot serve on CoBank's Board of Directors within one year of employment.

Director Independence

The Board must be composed at all times of at least 75 percent of directors who are deemed to be independent. The Board has adopted standards to assist it in making the annual affirmative determination of each director's independence status. A director will be considered "independent" if he or she meets the 14 criteria for independence set forth by the Board, which were established based upon leading industry practice and the listing standards of the New York Stock Exchange. For example, the loans from CoBank to an affiliated Association or Title III customer, as defined by the Farm Credit Act, where a CoBank director is also a director must not comprise more than 20 percent of the total loans of CoBank. In addition, the Board has made a determination as to each independent director that no relationship exists which, in the opinion of the Board, would interfere with the exercise of independent judgment in carrying out the director's responsibilities. In making these determinations, the Board reviewed and discussed information provided by the directors and by CoBank with regard to each director's business and personal activities as they may relate to CoBank and CoBank's management. Fourteen directors were considered to be independent as of December 31, 2010.

Information About Committees of the Board of Directors

The standing Board committees consist of the following: an Audit Committee, a Compensation Committee, an Executive Committee, a Governance Committee and a Risk Committee. The Board has adopted written charters for each of these Board committees. The full text of each charter is available on our website at www.cobank.com.

All standing Board committees report on their meetings at the regular meeting of the full Board. Minutes of each committee meeting are signed by the committee chair and secretary, or another individual acting in their place at the meeting.

In 2010, the Board of Directors held six regular meetings and standing committees of the Board of Directors held a total of 29 meetings. The primary responsibilities of each committee are described on the following pages.

Board of Directors Disclosure as of December 31, 2010

CoBank, ACB

Committee Responsibilities

Audit Committee

The Audit Committee members are appointed by the Board chair in consultation with the Board officers and committee chairs. The Audit Committee is governed by a formal charter and chaired by one of the Board's outside directors. All members of the Audit Committee are independent of management of the Bank and any other System entity. During 2010, the Audit Committee met during four of the regular meetings of the Board of Directors, including regular meetings in executive session with senior management, the Chief Risk Officer, the Internal Audit Director, the Director of the Asset Review, Collateral and Compliance Division, and the Bank's independent auditors. The Audit Committee reviews and approves the quarterly and annual financial statements.

Mr. Barry M. Sabloff serves as Chairman of the Audit Committee. The Board of Directors has determined that Mr. Sabloff has the qualifications and experience necessary to serve as an "audit committee financial expert," as defined by the rules of the Securities and Exchange Commission, and he was so designated.

The primary purpose of the Audit Committee is to assist the Board in fulfilling its oversight responsibilities by carrying out the following responsibilities:

- (1) Overseeing management's conduct of the Bank's financial reporting process and systems of internal accounting and financial controls;
- (2) Monitoring the independence and performance of the Bank's internal audit function, the risk assessment process, and the independent auditors;
- (3) Ensuring the Bank's compliance with legal and regulatory requirements; and
- (4) Providing an avenue of communication among the outside auditors, management and the Board.

Management has the primary responsibility for the consolidated financial statements and the financial reporting process, including the system of internal controls. The Audit Committee oversees the Bank's independent auditors, systems of internal accounting and financial controls, and financial reporting process on behalf of the Board of Directors. In this regard, the Audit Committee helps to ensure independence of the Bank's independent auditors, the integrity of management and the adequacy of disclosure to shareholders. The Audit Committee has unrestricted access to representatives of the internal audit division, independent auditors and financial management.

The Audit Committee preapproves all audit and audit-related services and permitted nonaudit services (including the fees and terms thereof) to be performed for the Bank by its independent auditors, as negotiated by management. The Audit Committee may form and delegate authority to the chairman of the Audit Committee, or a subcommittee of the Audit Committee (consisting of one or more members), when appropriate, including the authority to grant preapprovals of audit and permitted nonaudit services, provided that decisions of the chairman or any subcommittee to grant preapprovals is presented to the full Audit Committee at its next scheduled meeting.

The Audit Committee reviewed the audited consolidated financial statements in the Annual Report for the year ended December 31, 2010, with management and the Bank's independent auditors. The independent auditors are responsible for expressing an opinion on the conformity of the Bank's audited consolidated financial statements with accounting principles generally accepted in the United States of America, including a discussion of the quality of the Bank's accounting principles, the reasonableness of significant judgments, the clarity of disclosures in the consolidated financial statements and the adequacy of internal controls. The Audit Committee discussed with the independent auditors the results of the 2010 audit and all other matters required to be discussed by Statements on Auditing Standards. In addition, the Audit Committee received, reviewed and discussed the written disclosures from the independent auditors required by Independence Standards Board Standard No. 1, "Independence Discussions with Audit Committees." Based on the review and discussions described above, the Audit Committee recommended to the Board of Directors that the audited consolidated financial statements be included in the Bank's Annual Report for the year ended December 31, 2010 and for filing with the FCA.

Board of Directors Disclosure as of December 31, 2010

CoBank, ACB

Aggregate fees incurred by the Bank for services rendered by its independent auditors, PricewaterhouseCoopers LLP, for the years ended December 31, 2010 and 2009 were as follows:

| Year Ended December 31, | 2010 | 2009 |
|-------------------------|-------------------|-------------------|
| Audit | \$ 547,084 | \$ 546,148 |
| Audit-related | 15,000 | 71,000 |
| Tax | - | - |
| All Other | 1,500 | 1,500 |
| Total | \$ 563,584 | \$ 618,648 |

Audit fees were for the annual audit of the consolidated financial statements.

Audit-related fees were for assurance and related services primarily in connection with the CoBank/ U.S. AgBank merger initiative in 2010 and the preferred stock exchange in 2009.

All other fees were for accounting research software costs.

Compensation Committee

The Compensation Committee members are appointed by the Board chair in consultation with the Board officers and committee chairs. All members of the Compensation Committee are independent of management. The committee is primarily responsible for representing the Board in matters related to compensation programs for the Bank, including salary, incentive and benefits programs, and in facilitating the terms of employment, compensation and evaluation of the President and Chief Executive Officer. The committee also reviews the results of the Bank's affirmative action program and encourages programs to support diversity and inclusion.

Executive Committee

The Executive Committee members are appointed by the Board chair in consultation with the Board officers and committee chairs. The committee is primarily responsible for developing for Board consideration recommendations surrounding the design and implementation of the Bank's strategic plan. It acts on behalf of the Board between Board meetings when necessary. The Executive Committee is responsible for reviewing the Bank's budget and reports of operations, and for reviewing the capital adequacy plan and portfolio strategy. The committee reviews the Bank's annual business and financial plan and recommends such plan for approval by the Board. The committee also provides advice and counsel to the Board and management on policy matters related to capital and finance.

Governance Committee

The Governance Committee members are appointed by the Board chair in consultation with the Board officers and committee chairs. The committee is primarily responsible for monitoring and recommending for Board consideration corporate governance processes and structures that are consistent with leading practices. The committee coordinates the annual Board self-evaluation and a periodic director peer evaluation. The committee also oversees the Bank's director nomination process, which is conducted by the Nominating Committee (see page 114), and director election process. In addition, the committee annually assesses the needs of the Board – taking into account the experience and background of current directors – and also recommends prospective outside and appointed directors to the full Board.

Risk Committee

The Risk Committee members are appointed by the Board chair in consultation with the Board officers and committee chairs. The committee is primarily responsible for overseeing the enterprise risk management practices of the Bank, including management's ability to assess and manage the Bank's credit, market, interest rate, liquidity, legal and compliance, reputational, technology and operational risks. The committee also provides an open avenue of communication between management and the Board in order to effectively manage risks.

Board of Directors Disclosure as of December 31, 2010

CoBank, ACB

Other Committees

Nominating Committee

The Nominating Committee for 2010 consisted of nine customer-owner representatives, all of whom were elected by the Bank's stockholders. No member of the Board or management served on the Nominating Committee. This committee was charged with the responsibility to identify qualified candidates for Board membership and to review director nominations, helping to ensure that the Bank continues to attract a highly qualified and diverse Board. The Nominating Committee seeks candidates who are recognized leaders and who fulfill specific needs for industry and geographic diversity on the Board. Customers are encouraged to submit resumes of candidates for elected positions. The Nominating Committee makes a best effort to recommend at least two candidates for each position up for election. Shareholders and interested candidates may gather signatures for petitions to run for the Board following the conclusion of the Nominating Committee's work. A nominee cannot be associated with a party to an adversely classified CoBank or Farm Credit System loan unless he or she resigns or disaffiliates from such loan party by the date the term of office is to begin. A nominee must not have reached age 70 on or prior to the date the term of office is to begin and must meet other eligibility requirements established by Bank bylaws and federal regulations.

Restructuring Committee

The Restructuring Committee was appointed by the Board in 2010, pursuant to a requirement in the Bank's bylaws, to study the composition of the Board, and consider other factors to strengthen governance. The committee consisted of four members of the Board and four customer-owner representatives. Additionally, the Board appointed the chairman of the Board as an advisor to the committee. In accordance with the Bank's bylaws, the committee completed its study prior to December 31, 2010, and is expected to deliver its final report with recommendations to enhance corporate governance to the Board in the first quarter of 2011.

Special Review Committee

The Special Review Committee (the "SRC") was appointed in January 2010 by the chairman of the Board, in consultation with the Board officers, to provide independent oversight and review of the internal investigation being conducted by the Bank in connection with a business dispute. The SRC is also responsible for the Bank's responses to the regulatory requirements related to the dispute. The SRC consists of three members of the Board, including the chairmen of the Audit and Risk Committees.

Board of Directors Disclosure as of December 31, 2010

CoBank, ACB

The following represents certain information regarding the directors as of December 31, 2010, including business experience during the past five years. The terms of directors were scheduled to expire as of December 31 of the years indicated.

| | | |
|----------------------------|----------------------------------|--------------------------------|
| 1 - Audit Committee | 5 - Risk Committee | 9 - Governance Committee Chair |
| 2 - Compensation Committee | 6 - Audit Committee Chair | 10 - Risk Committee Chair |
| 3 - Executive Committee | 7 - Compensation Committee Chair | 11 - Special Review Committee |
| 4 - Governance Committee | 8 - Executive Committee Chair | 12 - Restructuring Committee |

| Name | Term Expires | Principal Occupation and Other Affiliations |
|---|--------------|--|
| Gene Batali ^{4, 5} Age: 69 Year Service Began: 2007 Also Served: 2003-2005 | 2013 | Principal Occupation: Owner/Operator: Batali Ranch, Inc., Yakima, WA. |
| Everett Dobrinski ^{2, 3, 7, 8} Chairman Age: 64 Year Service Began: 1999 | 2011 | Principal Occupation: Owner/Operator: Dobrinski Farm, a cereal grain and oilseed farm, Makoti, ND. Other Affiliations: Board Chairman: Verendrye Electric Cooperative, an electric distribution cooperative, Velva, ND; Director: Dakota Pride Cooperative, specialty crop marketing, Jamestown, ND; Director: North Dakota Coordinating Council for Cooperatives, a trade association, Jamestown, ND; Director: The Farm Credit Council, a trade organization, Washington, DC; Advisory Board: Quentin Burdick Center for Cooperatives at North Dakota State University, an advisory board to promote education and research on cooperatives, Fargo, ND. |
| Randal J. Ethridge ⁵ Age: 59 Year Service Began: 1997 | 2010 | Principal Occupation: Executive Vice President: People's Electric Cooperative, a rural electric distribution cooperative, Ada, OK; Owner/Operator: Ethridge Ranch, a cattle ranching operation, Stroud, OK. Other Affiliations: Director: Oklahoma Association of Electric Cooperatives, a trade association, Oklahoma City, OK; Alternate Director: Western Farmers Electric Cooperative, wholesale electric sales, Anadarko, OK. |
| William M. Farrow III ^{4, 5, 11} Age: 55 Year Service Began: 2007 | 2014 | Principal Occupation: Director, President and CEO: Urban Partnership Bank, a commercial bank, Chicago, IL; Owner: Winston and Wolfe LLC, a technology development and advisory company, Chicago, IL; Former Chief Executive Officer and Managing Partner: F.C. Partners Group, LLC, business advisor, Chicago, IL; Former Executive Vice President and Chief Information Officer: Chicago Board of Trade, Chicago, IL. |
| Mary E. Fritz ^{2, 3} Second Vice Chairman Age: 61 Year Service Began: 2003 | 2011 | Principal Occupation: Owner/Operator: Quarter Circle JF Ranch, Inc., a dry land grain and cow/calf operation, Chester, MT. Other Affiliations: Director: The Farm Credit Council, a trade organization, Washington, DC. |

Board of Directors Disclosure as of December 31, 2010

CoBank, ACB

| Name | Term Expires | Principal Occupation and Other Affiliations |
|---|--------------|---|
| William H. Harris ^{2, 3, 4, 12} Age: 61 Year Service Began: 2001 | 2011 | Principal Occupation: Owner/Operator: Harris Farms, a cash crop farming operation, LeRoy, NY; Partner: HR&W Harvesting, a processing vegetable farm, LeRoy, NY; President: Eatwell Farms, Inc., a custom field work operation, LeRoy, NY. Other Affiliations: Director: ACDI/VOCA, international agricultural development, Washington, DC. |
| Daniel T. Kelley ^{2, 3} First Vice Chairman Age: 62 Year Service Began: 2004 | 2013 | Principal Occupation: Owner/Operator: Kelley Farms, a diversified corn and soybean operation, Normal, IL. Other Affiliations: Chairman and President: GROWMARK, Inc., farm supply and grain marketing, Bloomington, IL; Chairman: Illinois Agricultural Leadership Foundation, agricultural leadership development, Macomb, IL; Director: Evergreen FS, Inc., a farm supply and grain marketing operation, Bloomington, IL; Director: Nationwide Mutual Insurance Company, an insurance company, Columbus, OH; Director: Nationwide Bank, a federal savings bank, Columbus, OH; Director: Midwest Grain, LLC, grain merchandising, Bloomington, IL. |
| James A. Kinsey ^{2, 3} Age: 61 Year Service Began: 2001 | 2012 | Principal Occupation: Owner/Operator: Kinsey's Oak Front Farms, a purebred angus seed-stock producer, Flemington, WV. Other Affiliations: Director: Farm Credit of the Virginias, ACA, agriculture finance, Staunton, VA; Director: Federal Farm Credit Banks Funding Corporation, Jersey City, NJ. |
| David J. Kragnes ^{1, 4, 12} Age: 58 Year Service Began: 2009 | 2012 | Principal Occupation: Owner/Operator of a wheat, sugar beet, soybean and corn farm in Felton, MN. |
| J. Scott Markham ¹ Age: 60 Year Service Began: 2010 | 2013 | Principal Occupation: Owner/Operator: Markham Farms, Inc., a dairy, diversified corn, dairy heifer and beef operation, Constableville, NY. |
| Gary A. Miller ¹ Age: 50 Year Service Began: 2006 | 2013 | Principal Occupation: President and Chief Executive Officer: GreyStone Power Corporation, an electric membership corporation, Douglasville, GA. Other Affiliations: Director: Wellstar Health System, healthcare, Marietta, GA; Chairman: GRESCO Utility Supply, Inc., electric material supplier, Smarr, GA; Treasurer: Douglas County Development Authority, an economic development agency, Douglasville, GA. |
| Catherine Moyer ⁵ Age: 35 Year Service Began: 2010 | 2014 | Principal Occupation: Director of Legal and Regulatory Affairs: Pioneer Communications, a rural telephone and communications company, Ulysses, KS. Other Affiliations: Chairman: Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO), a trade organization, Washington, D.C.; Director: Leadership Kansas, leadership program for Kansas civic and business leaders, Topeka, KS; Advisory Committee Member: Kan-ed, an educational interactive network, Topeka, KS. |

Board of Directors Disclosure as of December 31, 2010

CoBank, ACB

| Name | Term Expires | Principal Occupation and Other Affiliations |
|---|--------------|--|
| Robert D. Nattier ^{2, 3, 4, 9, 12} Age: 67 Year Service Began: 2003 | 2012 | Principal Occupation: Co-Operator: 4-N, Inc., a grain and livestock operation, Newton, KS; Owner: Foxridge Golf Club, Newton, KS. Other Affiliations: Director: North Newton Housing Authority, HUD development, North Newton, KS; Director: Wheatland Homes, HUD development, Newton, KS. |
| Barry M. Sabloff ^{1, 6, 11} Age: 64 Year Service Began: 2005 | 2012 | Principal Occupation: Vice Chairman/Director: Marquette National Corporation, a bank holding company, Chicago, IL; Vice Chairman/Director: Marquette Bank, a community bank, Chicago, IL. Other Affiliations: Director: Calypso Technology, Inc., a provider of trading systems to financial institutions, San Francisco, CA; Trustee: Columbia College Chicago, a private arts and media college, Chicago, IL; Director: The American School in London Foundation, an educational foundation, Princeton, NJ. |
| Richard W. Sitman ^{1, 4, 12} Age: 57 Year Service Began: 1999 Also Served: 1995-1996 | 2014 | Principal Occupation: Owner/Operator: Jos. M. Sitman, Inc., a retail business, Greensburg, LA. Other Affiliations: Chairman: Dixie Electric Membership Corporation, an electric distribution cooperative, Baton Rouge, LA; Chairman: DEMCO Energy Services, LLC, an electric service supplier, Baton Rouge, LA; Chairman: Dixie Business Center, a business incubator, Denham Springs, LA; Board Secretary: Bank of Greensburg, a commercial bank, Greensburg, LA; Director: The Farm Credit Council, a trade organization, Washington, DC. |
| Kevin A. Still ^{5, 10, 11} Age: 53 Year Service Began: 2002 | 2014 | Principal Occupation: Chief Executive Officer and Treasurer: Co-Alliance, LLP, a partnership of five cooperatives supplying energy, agronomy and animal nutrition, producing swine and marketing grain, Avon, IN; Chief Executive Officer and Treasurer: Midland Co-op, Inc., Frontier Co-op, Inc., LaPorte County Co-op, Inc., and Excel Co-op, Inc., agricultural retail cooperatives, Avon, IN. Other Affiliations: President and Owner: Still Farms LLC, a grain farm, Galesburg, IL. |

Board of Directors Disclosure as of December 31, 2010

CoBank, ACB

Compensation of Directors

For 2010, directors were compensated in cash at an annual rate of \$52,133, paid in quarterly installments, which was the maximum amount permitted by the FCA for CoBank directors. Directors may elect to defer payment of all or part of their director compensation in accordance with agreements and applicable law. Compensation is for attendance at Board meetings, certain other meetings preapproved by the Board, and special duties as assigned. Directors' compensation is reduced by \$2,500 for an unexcused absence at any regular Board meeting. FCA regulations also allow additional compensation to be paid to a director in exceptional circumstances where extraordinary time and effort are involved. In 2010, the Board approved additional compensation in excess of \$52,133 to the Board and Audit Committee chairmen, members of the Governance, Executive, Compensation, Special Review and Restructuring Committees, and to all other directors for greater than normal involvement in connection with special assignments, including matters related to a potential merger with U.S. AgBank, FCB. Total cash compensation paid to all directors as a group during 2010 was \$981,288. Additional information for each director who served during 2010 is provided below. Current CoBank policy regarding reimbursements for travel, subsistence and other related expenses states that for meetings designated by the Board and approved special assignments, Board members shall be reimbursed for reasonable travel and related expenses that are necessary and that support CoBank's business interests. As may be appropriate, CoBank may share in the reimbursement of expenses with other organizations. A copy of CoBank's policy is available to shareholders upon request. The aggregate amount of reimbursement for travel, subsistence and other related expenses for all directors as a group was \$366,263, \$323,928 and \$366,299 for the years ended December 31, 2010, 2009 and 2008, respectively.

| Name of Director | Number of Days Served at Board Meetings | Number of Days Served in Other Official CoBank Activities | Total Compensation Paid During 2010 |
|-----------------------|---|---|-------------------------------------|
| Gene Batali | 20 | 41 | \$ 57,533 |
| Everett Dobrinski* | 19 | 90 | 67,773 |
| Randal J. Ethridge | 19 | 19 | 56,733 |
| William M. Farrow III | 19 | 46 | 67,773 |
| Mary E. Fritz* | 19 | 60 | 64,833 |
| William H. Harris | 19 | 40 | 60,633 |
| Daniel T. Kelley | 19 | 52 | 64,433 |
| James A. Kinsey* | 19 | 16 | 56,033 |
| David J. Kragnes | 19 | 25 | 58,633 |
| J. Scott Markham | 19 | 36 | 55,233 |
| Gary A. Miller | 19 | 30 | 55,233 |
| Catherine Moyer | 19 | 28 | 55,233 |
| Robert D. Nattier | 19 | 53 | 67,033 |
| Barry M. Sabloff | 20 | 53 | 67,773 |
| Richard W. Sitman* | 19 | 30 | 58,633 |
| Kevin A. Still | 19 | 47 | 67,773 |
| Total | 306 | 666 | \$ 981,288 |

* In 2010, these directors represented CoBank's interests by serving on the Boards of various trade groups and other organizations important to the Bank.

Days of service related to these activities and compensation received (if any) are not included in this report.

Senior Officers

CoBank, ACB

Robert B. Engel, President and Chief Executive Officer

Mr. Engel was appointed president and chief executive officer effective July 1, 2006. Mr. Engel is responsible for implementing the Bank's strategic and business direction as set by the Board of Directors. He serves as chairman of the Board of Directors of Farm Credit Leasing Services Corporation (FCL). Mr. Engel also serves as the vice chairman of the Board of Directors of the Federal Farm Credit Banks Funding Corporation. Prior to joining CoBank in 2000 as president and chief operating officer, he was chief banking officer at HSBC Bank USA. During his 14-year tenure at HSBC, Mr. Engel served in a variety of management and credit positions. Mr. Engel has 26 years of banking experience, and eight years of accounting experience with KPMG and Deloitte & Touche. He serves on the Boards of Trustees of each of Regis University, New Ventures in Higher Education, Inc., the Graduate Institute of Cooperative Leadership, Buffalo Sabres Alumni Association, and as trustee emeritus at Niagara University. He also serves as vice chairman of the National Council of Farmer Cooperatives.

Mary E. McBride, Chief Banking Officer

Ms. McBride was appointed chief banking officer effective September 7, 2010. Ms. McBride manages all of CoBank's banking groups that are included in the Agribusiness, Strategic Relationships and Rural Infrastructure operating segments. Prior to her current position, Ms. McBride was CoBank's chief operating officer. Previous to that, she was executive vice president for the Bank's Rural Infrastructure Banking Group (formerly known as the Communications and Energy Banking Group). Before joining CoBank in 1993, Ms. McBride worked as senior vice president of Wells Fargo/First Interstate Bank of Denver, N.A. Prior to that, she was assistant vice president at Bank of Boston. In total, Ms. McBride has more than 30 years of financial services experience. Ms. McBride is a member of the USDA and DOE Biomass Research and Development Technical Advisory Committee. She also serves on the Board of Directors for the Denver Metropolitan Affiliate of Susan G. Komen for the Cure.

Ann E. Trakimas, Chief Operating Officer

Ms. Trakimas was appointed chief operating officer effective January 3, 2011. Ms. Trakimas oversees the Finance, Corporate Services, Regulatory, Legislative and Compliance areas. Before joining CoBank, Ms. Trakimas served as a director on the board of the Federal Farm Credit Banks Funding Corporation for five years. She also served as chairman of the Funding Corporation's Audit Committee and as a member of the Systemwide Audit Committee. Prior to that, she worked for Goldman Sachs, where she held numerous executive positions including head of the firm's Financial Institutions Credit Risk Management and Advisory team. Ms. Trakimas has more than 30 years of experience in the financial services industry.

Douglas E. Wilhelm, Chief Risk Officer

Mr. Wilhelm was appointed chief risk officer effective August 9, 2010. Mr. Wilhelm oversees all key risk areas of the business, including credit risk, operational risk, asset/liability and market risk, and reputation risk. Prior to his current position, Mr. Wilhelm was chief credit and risk officer from July 2006 to August 2010. Mr. Wilhelm has managed several areas within CoBank, including risk management, financial planning and credit support functions. From 1972 to 1988, he held various financial and accounting management functions for several other Farm Credit entities. Mr. Wilhelm serves as chairman of the Board of Directors of Food Bank of the Rockies.

David P. Burlage, Chief Financial Officer

Mr. Burlage was appointed chief financial officer effective November 16, 2009. Mr. Burlage oversees the Controller and Treasury areas of the Bank, which include the funding, asset/liability management, financial planning, capital, accounting, tax and reporting functions of the Bank. Prior to his current position, Mr. Burlage served as senior vice president of the Finance Division. Before joining CoBank in 2002, Mr. Burlage was the chief financial officer at Interlink Group, Inc., an IT professional services company. Earlier, Mr. Burlage was with Titanium Metals Corporation and Arthur Andersen & Co. Mr. Burlage has over 25 years of financial experience. He is a CPA and member of the American Institute of Certified Public Accountants.

Senior Officers (Continued)

CoBank, ACB

**John C. Holsey,
Deputy Chief Banking Officer**

Mr. Holsey was appointed deputy chief banking officer for all of CoBank's banking groups included in the Agribusiness, Strategic Relationships and Rural Infrastructure operating segments effective October 1, 2009. Effective September 7, 2010, Mr. Holsey temporarily assumed responsibility for management of the Bank's Rural Infrastructure Banking Group. Prior to his current position, Mr. Holsey served as executive vice president of the Bank's Global Financial Services Group, which included corporate finance, international banking and trade finance, capital markets and non-credit services. Prior to joining CoBank in 2000, Mr. Holsey was executive vice president with HSBC Bank USA, and, prior to that, served in a variety of management and credit positions at HSBC (both in New York and Hong Kong). Mr. Holsey has 37 years of domestic and international banking experience. He also serves on the Board of Directors of the National Cooperative Business Association.

**Lori L. O'Flaherty,
Chief Credit Officer**

Ms. O'Flaherty was appointed chief credit officer effective August 9, 2010. Ms. O'Flaherty is responsible for credit approval functions, as well as credit support and analysis, credit guidelines and training, loan compliance and monitoring and special assets. Prior to her current position, Ms. O'Flaherty was executive vice president of credit approval and administration, and, prior to that, she managed CoBank's Corporate Finance Division. Before joining CoBank in 1997, Ms. O'Flaherty was vice president of Wells Fargo/First Interstate Bank, N.A. Ms. O'Flaherty has 27 years of experience in commercial banking. She serves as treasurer on the Board of Directors of Big Brothers Big Sisters of Colorado, Inc.

**John Svisco,
Chief Administrative Officer**

Mr. Svisco was appointed chief administrative officer effective September 7, 2010. Mr. Svisco is responsible for directing the Bank's information technology, operations, corporate communications and human resources areas. Prior to his current position, Mr. Svisco was senior vice president of human resources and administrative services divisions. Mr. Svisco joined CoBank in August 2002 and managed lease and loan operations during his first seven years at the Bank. Prior to joining CoBank, Mr. Svisco spent 20 years with HSBC Bank USA, where his last position was senior vice president of operations services.

Philip S. DiPofi

Mr. DiPofi served as chief banking officer through September 6, 2010.

Mark W. Yonkman

Mr. Yonkman served as chief legal and regulatory officer through September 10, 2010.

Senior Officers Compensation Discussion and Analysis

CoBank, ACB

Overview

This section describes the compensation program for CoBank's President and Chief Executive Officer (President and CEO) and other senior officers, as defined by FCA regulations (collectively, senior officers), and presents the compensation earned by our President and CEO, as well as aggregate compensation earned by our other senior officers, for the years ended December 31, 2010, 2009 and 2008. We did not make any changes to the design of our compensation programs in 2010, which we believe are structured to be aligned with our shareholders' long-term interests and best practices in governance of executive compensation.

The Board of Directors, through its Compensation Committee (Committee), has adopted a total compensation philosophy for the Bank. Our total compensation philosophy is intended to align the interests of our senior officers with those of our shareholders and is more fully described below. We accomplish this by providing incentive compensation that rewards for performance that meets or exceeds the business plan established by our Board of Directors.

As described in the 'Overview' section of Management's Discussion and Analysis on page 29 of this Annual Report, in 2010 CoBank recorded strong financial performance amidst challenging conditions in the broader economy. As a result of our strong business and financial performance, our short-term incentive plan for 2010 was funded between the target and maximum award levels. In addition, based on performance in the 2008 to 2010 period, our long-term incentive plan was also funded between the target and maximum award levels. These and other elements of our senior officers' compensation are explained below.

Compensation Philosophy and Objectives

The Bank's total compensation philosophy is designed to maintain a compensation program that will:

- Attract, retain and reward associates with the skills required to accomplish the Bank's strategic business objectives;
- Provide accountability and incentives for achievement of those objectives;
- Link compensation to Bank performance and increased shareholder value;
- Properly balance the risk profile of the Bank with both short- and long-term incentives;
- Be designed within a consistent philosophy and framework;
- Create a culture of adherence to core values and strong ethical behavior; and
- Be integrated with the Bank's business processes, including business planning, performance management and succession planning.

The total compensation philosophy seeks to achieve the appropriate balance among market-based salaries, variable incentive compensation and benefits designed to incent and reward both the current and long-term achievement of our strategic business objectives and business and financial plans. It also seeks to incent prudent risk taking within Board-established parameters with the proper balance and accountabilities between short- and long-term business performance. For senior officers, CoBank strives to deliver a significant portion of total target compensation through performance-based pay, with the actual proportion of total compensation provided through both short- and long-term incentives varying with actual financial performance, the achievement of Board-approved strategic business objectives and each senior officer's individual performance. We believe this philosophy fosters a performance-oriented, results-based culture wherein compensation varies on the basis of results achieved and is properly aligned with an acceptable risk profile and shareholder returns.

Process for Compensation Decisions

The Board of Directors has established the Committee to oversee the design, implementation and administration of compensation and benefits programs for CoBank. The Committee meets regularly to execute the responsibilities of its Charter. The Committee reviews the performance of the Bank's President and CEO semi-annually, and the Board of Directors annually approves the compensation level of the President and CEO, including salary and short- and long-term incentive compensation. The President and CEO is responsible for setting the compensation levels of the senior officers directly reporting to him, with the Committee reviewing the compensation of the most senior of those officers who, in turn, are responsible for the compensation of all other employees.

Senior Officers Compensation Discussion and Analysis

CoBank, ACB

The Committee generally makes decisions regarding the President and CEO's salary and incentive compensation in its February meeting to fully take into consideration the prior year's Bank and individual performance. Decisions may also occur at other meetings in the year, as considered appropriate. The Committee utilizes an independent executive compensation consultant, Pay Governance LLC (Consultant), to annually compare the President and CEO's compensation level to a select peer group of financial institutions. This evaluation helps ensure that such compensation is competitive with positions of similar scope and complexity at relevant financial institutions. The comparative peer group is composed of companies with significant corporate and commercial lending activities, and which have other similar characteristics such as asset size, net income or significant customer relationships. Substantially all work performed by the Consultant in 2010 was completed under the direction of the Committee. Certain limited work was performed by the Consultant on behalf of the Bank with the prior approval of the Committee.

Components of CoBank Total Compensation Program

Given the cooperative ownership structure of CoBank, no equity or stock-based plans are used to compensate any employee, including senior officers. Senior officers' compensation primarily consists of four components – salary, short-term incentive plan, long-term incentive plan and retirement benefits – as described below. All employees participate in salary, the short-term incentive plan and retirement benefits, while senior officers and specified other senior managers are also eligible to participate in the long-term incentive plan. All senior officers can elect to defer certain incentive payments through a nonqualified deferred compensation plan. In addition, senior officers are eligible for supplemental retirement benefits, as discussed on page 127.

| Overview of Senior Officers' Compensation | | |
|---|---|--|
| Component | CoBank Philosophy | Design Characteristics |
| Salary | <ul style="list-style-type: none"> Market-based compensation Provides a foundation for other components Competitive relative to positions of similar scope at a select peer group of financial institutions Reflects individual performance, competencies and responsibilities | |
| Short-Term Incentive Plan | <ul style="list-style-type: none"> Links rewards to achievement of annual goals Recognizes corporate and individual performance Aligns the interests of shareholders and senior officers through bankwide financial and strategic business objectives Balances short-term results with the risk profile of the Bank | <ul style="list-style-type: none"> Multiple corporate financial and non-financial goals Minimum performance for each goal required Minimum return on active patron stock investment of 11% required in year of payout Individual and corporate performance weighted equally |
| Long-Term Incentive Plan | <ul style="list-style-type: none"> Provides opportunity for wealth accumulation tied to CoBank's sustained performance Reinforces accountability and balance for the annual outcomes embodied in the short-term incentive plan Balances short-term results and long-term value creation Encourages longer-term retention of plan participants Promotes the creation of profitable growth in shareholder and customer value, and enhances the sustainability of CoBank to serve its customers while providing proper balance to the risk profile of the Bank Aligns the interests of shareholders and senior officers through bankwide financial and strategic business objectives | <ul style="list-style-type: none"> Multiple corporate financial and non-financial goals Three-year performance periods New plan starts each year (plans overlap) Minimum performance for each goal required Minimum return on active patron stock investment of 11% must be achieved in each year of the plan for a full payout |

Senior Officers Compensation Discussion and Analysis

CoBank, ACB

| Overview of Senior Officers' Compensation (continued) | | |
|---|---|--|
| Component | CoBank Philosophy | Design Characteristics |
| Retirement Benefits | <ul style="list-style-type: none"> Provides for a source of income subsequent to retirement Encourages longer-term retention of plan participants | <ul style="list-style-type: none"> Benefits vary based on date of hire Senior officers hired prior to January 1, 2007 (all of our senior officers as of December 31, 2010) participate in a defined benefit plan and supplemental retirement plan Senior officers hired on or after January 1, 2007 receive employer defined contribution benefits Other retirement benefits include a 401(k) retirement savings plan and access to healthcare benefits. Substantially all participants pay the full premiums associated with postretirement healthcare benefits |

Salary

Overview

Salary Considerations

- Individual performance and competencies
- Maintenance or expansion of responsibilities and scope of position
- Peer group data and internal equity
- Overall CoBank merit budget

Salaries represent a foundational component of CoBank's total compensation program as the amounts of other components are determined in relation to base salary. Senior officer salaries are market-based and established taking into consideration individual performance, the specific competencies and experience the senior officer brings to CoBank, the responsibilities and scope of the position, peer group data and internal equity. Salaries for senior officers are generally adjusted annually within the parameters established in the Board-approved business and financial plan.

Short-Term Incentives

Overview

Short-Term Incentive Plan (STIP)

- Corporate and individual performance weighted equally
- Corporate financial performance measures are balanced: profitability, loan quality and operating efficiency
- Board of Directors also provides subjective evaluation related to achievement of corporate strategic business objectives
- All associates are eligible to participate
- For 2010, CoBank performed above maximum award levels on two performance goals and between target and maximum award levels on three other performance goals

Annual short-term incentive payments are based on a combination of annual corporate and individual performance. The short-term incentive plan, which has the same design for all employees, including the President and CEO and other senior officers, aligns the interests of shareholders and employees through the establishment of a balanced scorecard of bankwide financial and strategic business objectives. Under the terms of the plan, a minimum return on active patron stock investment must be achieved for the plan year in order for a payout to be approved, ensuring that shareholders are rewarded first. The return minimum was 11 percent for the years ended December 31, 2010, 2009 and 2008.

Senior Officers Compensation Discussion and Analysis

CoBank, ACB

The actual short-term incentive award is determined as follows:

$$\text{Salary} \times \text{Annual Short-Term Incentive Target} \times \text{Corporate Performance Factor} \times \text{Individual Performance Factor}$$

Based on corporate and individual performance factors, participants can earn from zero to 400 percent of their individual annual short-term incentive target. Payments are typically made during March, but always following the end of the year to which the award is applicable. Participants are not eligible to receive a short-term payout if they are no longer employed by CoBank at the time of the scheduled payout, unless otherwise provided for in an employment agreement. The key elements of the actual payout are described below.

- *Annual Short-Term Incentive Target* — Annual short-term incentive targets are set for all employees at the beginning of the year. For the 2010 performance period, the target short-term incentive level for the President and CEO was 65 percent of salary. For the other senior officers, the targets ranged from 30 to 55 percent.
- *Corporate Performance Factor* — Corporate performance is determined at the end of the year based on annual actual business results relative to a balanced scorecard of bankwide financial and strategic business objectives, as established at the beginning of each year by the Board of Directors, and is the same for all employees, including the President and CEO and other senior officers. The Board of Directors retains the right to make adjustments to the corporate performance factor, where appropriate, in addition to providing a subjective performance result for the achievement of certain strategic business objectives.

CoBank utilizes a balanced scorecard for measuring short-term corporate performance to emphasize overall success in executing our strategy and managing risks. The short-term corporate scorecard establishes certain key performance indicators, of which 80 percent focus on the achievement of specified financial measures related to profitability, loan quality and operating efficiency, and 20 percent focus on the achievement of certain strategic business objectives, as determined at the beginning of each year by the Board of Directors. The final performance result, or corporate performance factor, is determined by comparing the actual performance of each measure to the targets established at the beginning of the year. Each scorecard performance measure is weighted separately, and the factor is set such that if performance of each measure exactly meets the established target, the result is a performance factor of 100 percent. The corporate performance factor can vary from zero to a maximum of 200 percent, depending on performance against the targets. The 2010 Short-Term Corporate Scorecard is as follows:

| 2010 Short-Term Corporate Scorecard | |
|--|--------|
| Performance Measure | Weight |
| Net Income | 30 % |
| Return on Common Equity | 20 % |
| Strategic Business Objectives | 20 % |
| Loan Quality (Adverse Loans to Risk Funds) | 20 % |
| Operating Expense Ratio | 10 % |

As noted on page 33 of this Annual Report, the Bank settled a business dispute in early 2010. However, the events that led to the dispute occurred prior to December 31, 2009. While the amounts involved were not considered material enough to adjust the Bank's 2009 audited financial statements prior to issuance in March 2010, the Board of Directors made a pro forma adjustment to the actual financial results used in the calculation of the 2009 corporate performance factor and reduced net income by approximately \$13.7 million to account for the settlement, net of related reductions in incentive compensation and income taxes. The adjustment to net income reduced the 2009 corporate performance factor. In addition, the individual performance factors of certain associates, including certain senior officers, were reduced. In total, 2009 short-term incentive payments were reduced by \$2.4 million, or 13 percent. A pro forma adjustment was also made to the actual financial results used in the calculation of the 2010 corporate performance factor to avoid having the costs related to the settlement negatively impact incentive compensation in both periods.

Senior Officers Compensation Discussion and Analysis

CoBank, ACB

- *Individual Performance Factor* — At the beginning of each year, all CoBank employees, including the President and CEO and other senior officers, establish individual goals they seek to achieve that year in support of the business. These individual goals are anchored to the Bank's business and financial plan, as well as the Bank's strategic business objectives and also include key behavioral competencies appropriate for that employee. The President and CEO is responsible for administering the short-term incentive plan and approves the individual performance factors of the other senior officers. The Board of Directors approves the goals and individual performance factor of the President and CEO. The assessment of an individual's actual performance with respect to his or her annual goals is reflected as an individual performance factor and ranges from zero to 200 percent.

The actual short-term incentive awards for 2010, 2009 and 2008 for the President and CEO and other senior officers are presented in the Summary Compensation Table on page 130.

Long-Term Incentives

Overview

Long-Term Incentive Plan (LTIP)

- Awards based upon corporate performance for overlapping three-year periods
- Corporate financial performance measures are balanced: profitability, loan quality, capital adequacy
- Board of Directors also provides subjective evaluation related to the achievement of corporate strategic business objectives
- For the 2008 to 2010 performance period, CoBank performed above maximum award levels on five performance goals and between target and maximum award level on one other performance goal

CoBank utilizes a long-term incentive compensation plan that provides senior officers and specified other senior managers with the opportunity for wealth accumulation tied to CoBank's sustained success. The long-term incentive plan provides the accountability and balance for the annual outcomes embodied in the short-term plan. Participants in the long-term plan are directly impacted by the longer-term outcomes of actions and risks taken during each annual employment period, which provides the proper balance between short-term results and long-term value creation. Eligibility for participation is limited to those individuals who clearly have the ability to drive the success of strategies critical to long-term value creation for shareholders. The purpose of this plan is to encourage longer-term retention of plan participants, to promote the creation of profitable growth in shareholder and customer value, and to enhance the sustainability of CoBank to serve its customers while providing proper balance to the risk profile of the Bank. The long-term incentive plan aligns the interests of shareholders and senior officers through the establishment of bankwide financial and strategic business objectives, and reinforces a long-term focus on financial performance, strategic positioning and risk management.

Long-term incentive plan payouts are based on corporate performance in the achievement of key financial metrics and strategic business objectives over a three-year performance period, as defined by CoBank's long-term corporate scorecard. These three-year performance metrics and objectives are established at the beginning of each three-year performance period by the Board of Directors in connection with the annual business and financial plan. A minimum return on active patron stock investment must be achieved in each year of the three-year performance period for a full payout to be approved, ensuring that shareholders are rewarded first. The return minimum is 11 percent for the 2008 through 2010, 2009 through 2011, and 2010 through 2012 performance periods.

The actual long-term incentive award is determined as follows:

$$\text{Salary} \times \text{Long-Term Incentive Target} \times \text{Corporate Performance Factor}$$

Senior Officers Compensation Discussion and Analysis

CoBank, ACB

Based on the corporate performance factor, participants can earn from zero to 200 percent of their individual long-term incentive target. Payments are typically made during March of each year following the end of the three-year performance period to which the award is applicable. Participants are not eligible to receive a full payment at the time of the scheduled payout if their performance did not meet expectations during the performance period, or if their employment terminated for reason of retirement, death or disability during the performance period. Participants are not eligible to receive any payment at the time of the scheduled payout if they are no longer employed by CoBank for reasons other than retirement, death or disability, unless otherwise provided for in an employment agreement. The key elements of the actual payout are described below.

- *Long-Term Incentive Target* — For the 2008 through 2010 performance period, the long-term incentive target for the President and CEO was 125 percent of salary. For the remaining senior officers, the targets ranged from 40 to 65 percent.
- *Corporate Performance Factor* — Corporate performance is determined at the end of a designated three-year period based on actual business results relative to a balanced scorecard of bankwide financial and strategic business objectives, as established at the beginning of the three-year performance period by the Board of Directors. The Board of Directors retains the right to make adjustments to the corporate performance factor, where appropriate, in addition to providing a subjective performance result for the achievement of certain strategic business objectives.

CoBank utilizes a balanced scorecard for measuring long-term corporate performance to emphasize overall success in executing our strategy and managing risks. The long-term corporate scorecard establishes certain key performance indicators, of which 80 percent focus on the achievement of specified financial measures related to profitability, loan quality and capital adequacy, and 20 percent focus on the achievement of certain strategic business objectives, as determined at the beginning of each three-year performance period by the Board of Directors. Beginning with the 2009 through 2011 performance period, the scorecard was modified to increase the weighting of the loan quality performance measure and to eliminate the fee income performance measure. This change was made to better align the scorecard with the Bank's risk profile. The final performance result, or corporate performance factor, is determined by comparing the actual performance of each measure to the targets established at the beginning of each three-year performance period. Each scorecard performance measure is weighted separately, and the factor is set such that if performance of each measure exactly meets the established target, the result is a performance factor of 100 percent. The corporate performance factor can vary from zero to a maximum of 200 percent, depending on performance against the targets. The Long-Term Corporate Scorecards for the three-year performance periods 2008 through 2010, 2009 through 2011 and 2010 through 2012 are as follows:

| Long-Term Corporate Scorecard: 2008 – 2010 Period | |
|---|--------|
| Performance Measure | Weight |
| Net Income | 20 % |
| Permanent Capital Ratio | 20 % |
| Return on Common Equity | 20 % |
| Strategic Business Objectives | 20 % |
| Loan Quality (Adverse Loans to Risk Funds) | 10 % |
| Fee Income | 10 % |

| Long-Term Corporate Scorecards: 2009 - 2011 and 2010 – 2012 Periods | |
|--|--------|
| Performance Measure | Weight |
| Net Income | 20 % |
| Permanent Capital Ratio | 20 % |
| Return on Common Equity | 20 % |
| Strategic Business Objectives | 20 % |
| Loan Quality (Adverse Loans to Risk Funds) | 20 % |

Senior Officers Compensation Discussion and Analysis

CoBank, ACB

In calculating the 2010 and 2009 corporate performance factors for the long-term incentive plan, the Board of Directors made the same pro forma adjustments to actual results to reflect the settlement of a business dispute as described in “Short-Term Incentives” beginning on page 123. As the impacted performance measures were at maximum award levels, there was no effect on the total corporate performance factor for the long-term incentive plan in either period.

The actual long-term incentive awards for 2010, 2009 and 2008 for the President and CEO and other senior officers are presented in the Summary Compensation Table on page 130.

Terms of Senior Officers’ Employment Agreements

As of December 31, 2010, two of our senior officers, including the President and CEO, are employed pursuant to employment agreements, which provide specified compensation and related benefits to these senior officers in the event their employment is terminated, except for termination for cause. In the event of termination except for cause, the employment agreements provide for (a) payment of the officer’s prorated salary and incentives through the date of the termination, (b) semi-monthly payments aggregating two to three times the sum of the officer’s base compensation and short-term incentives at target, (c) enhanced retirement benefits if the termination results from a change in control, (d) the continued participation in the Bank’s health and welfare benefits over a two or three year period, and (e) certain other benefits over a two or three year period to the same extent as such benefits were being provided on the date of termination. The employment agreements also provide certain limited payments upon death or disability of the officer. To receive payments and other benefits under the agreements, the officer must sign a release agreeing to give up any claims, actions or lawsuits against the Bank that relate to his or her employment with the Bank. The agreements also provide for non-competition and non-solicitation by the officers over the term of the payments.

Retirement Benefits

Overview

We have employer-funded qualified defined benefit pension plans, which are noncontributory and cover employees hired prior to January 1, 2007. Depending on the date of hire, benefits are determined either by a formula based on years of service and final average pay, or by the accumulation of a cash balance with interest credits and contribution credits based on years of service and eligible compensation. We also have a noncontributory, unfunded, nonqualified supplemental executive retirement plan (SERP) covering all senior officers employed at December 31, 2010, as well as specified other senior managers. In addition, as more fully discussed below, we have a noncontributory, unfunded nonqualified executive retirement plan (ERP) designed to provide enhanced retirement benefits to the two senior officers employed pursuant to employment agreements, including the President and CEO. All employees are also eligible to participate in a 401(k) retirement savings plan, which includes employer matching contributions. Employees hired on or after January 1, 2007, receive additional employer defined contributions. All retirement-eligible employees, including senior officers, are also currently eligible for other postretirement benefits, which primarily include access to health care benefits. Substantially all participants pay the full premiums associated with these other postretirement health care benefits.

Defined Benefit Pension Plans

All senior officers employed as of December 31, 2010 are participants in the defined benefit pension plan. Pursuant to this plan, the benefits, including those of the President and CEO, are determined based on years of service and final average pay. Eligible compensation, as defined under the final average pay formula, is the highest 60 consecutive-month average, which includes salary and incentive compensation measured over a period of one year or less, but excludes long-term incentive awards, expense reimbursements, taxable fringe benefits, relocation allowance, short- and long-term disability payments, nonqualified deferred compensation distributions, lump sum vacation payouts and all severance payments. Retirement benefits are calculated assuming payment in the form of a single life annuity with five years certain and retirement at age 65. However, the actual form and timing of payments are based on participant elections. The plan requires five years of service to become vested. All senior officers participating in the defined benefit pension plan have been employed for more than five years and, as such, are fully vested in the plan. The benefit formula is the sum of 1.5 percent of eligible compensation up to Social Security covered compensation plus 1.75 percent of eligible compensation in excess of Social Security covered compensation, multiplied by the years of eligible benefit service. Social Security covered compensation is the 35 year average of the Social Security taxable wage bases up to the participant’s Social Security retirement age.

Federal laws limit the amount of compensation we may consider when determining benefits payable under the qualified defined benefit pension plans. We maintain a SERP that pays the excess pension benefits that would have been payable under our qualified defined benefit pension plans.

Senior Officers Compensation Discussion and Analysis

CoBank, ACB

Executive Retirement Plan

As noted previously, an ERP has been adopted for the President and CEO and one of the other senior officers subject to their respective employment agreements. The President and CEO's agreement provides for a minimum retirement benefit of 41 percent of eligible compensation as of December 31, 2010, increasing to a maximum of 55 percent of eligible compensation as of December 31, 2015, with no reduction for early retirement. The ERP is limited such that benefits provided under that plan are payable only if total retirement benefits payable per year from the three retirement plans do not exceed \$850,000, expressed as a single life annuity with five years certain. The ERP is integrated with the existing final average pay defined benefit retirement plan and the existing SERP. It provides the required additional retirement benefits to the extent such benefits are not covered by the other two plans, but only up to the maximum total retirement benefits noted above. If benefits exceed this maximum, no benefits are payable from the ERP. In the event of the death of the President and CEO during the term of his employment with the Bank, the plan provides a death benefit to a surviving spouse equal to the minimum retirement benefit described above. The benefits provided to the other senior officer under the ERP are the same as those provided to the President and CEO, but at reduced levels.

Nonqualified Deferred Compensation Plan

We have a nonqualified deferred compensation plan that allows senior officers and other eligible senior managers to defer all or a portion of their incentive compensation. Additionally, the Bank makes contributions to this plan on behalf of participants whose benefits under the 401(k) plan are limited due to federal tax laws. Contributions are made at the same percentages as available under the 401(k) plan. The compensation that is deferred is invested in any number of investment alternatives selected by the participants. These alternatives are either identical or substantially similar to those available to all participants in the Bank's 401(k) plan. The participant is subject to all risks and returns of amounts invested. The election to defer is irrevocable and the deferred amounts cannot be paid except in accordance with specified elections as permitted by law. At that time, the participant will receive payment of the amounts credited to his or her account under the plan in a manner that has been specified by the participant. If a participant dies before the entire amount has been distributed, the undistributed portion will be paid to the participant's beneficiary.

Risk Review

The Committee considers potential risks when reviewing and approving compensation programs. The Board of Directors approves the total compensation program to ensure there is a proper balance and alignment between the overall acceptable risk profile of the Bank and the manner in which prudent risk taking is reflected in the design of the underlying program. We have designed our total compensation program, including our incentive compensation plans, with specific features to address potential risks while rewarding employees for achieving short-term and long-term financial and strategic objectives through prudent business judgment and appropriate risk taking. The objective is to motivate employees to take prudent risk within Board-approved parameters while ensuring employees are also accountable for the long-term outcomes of their actions. The following elements have been incorporated in our compensation programs available for our senior officers:

- *A Balanced Mix of Compensation Components* – The target compensation mix for our senior officers is composed of salary, short-term incentive, long-term incentive and retirement benefits, representing a mix that is weighted toward long-term performance and service with CoBank.
- *Multiple Performance Factors* – Our incentive compensation plans use both bankwide metrics and individual performance, which encourage focus on the achievement of objectives for the overall benefit of the Bank, in addition to a Board-determined evaluation of our strategic objectives.
 - The short-term incentive is dependent on multiple performance metrics, including a subjective measure of performance against strategic business objectives and an assessment of individual performance.
 - The long-term incentives are cash-based, with a three-year performance and vesting period to complement our annual short-term incentives.
 - Board of Directors retains the right to adjust performance factors.

Senior Officers Compensation Discussion and Analysis

CoBank, ACB

- *Caps on Incentive Payments* – Our incentive compensation plan payments are subject to caps that limit the maximum award that may be paid.
- *Approval of Plan Funding* – The Committee approves all incentive plan funding following a review of the Bank’s performance against plan performance criteria established and approved prior to the beginning of the incentive plan performance period.
- *Shareholder Return* – A minimum return on active patron stock investment must be achieved for incentive compensation payments to be approved.

Additionally, in 2010, the Committee completed an assessment of compensation-related risks for all of our employees. Based on this assessment, the Committee concluded that our compensation programs do not create risks that are reasonably likely to have a material adverse effect. In making this evaluation, the Committee reviewed the key design elements of our compensation programs in relation to industry “best practices” as presented by the Consultant, as well as the means by which any potential risks may be mitigated, such as through our internal controls and oversight by management and the Board of Directors. In addition, in 2010, management completed an analysis of incentive programs and reviewed the design of these incentives both internally and with the Consultant to conclude that such incentive programs do not encourage excessive risk-taking.

The President and CEO has elected to receive retirement benefits payable pursuant to the SERP and ERP in the form of an annuity, as opposed to a lump sum. The Compensation Committee believes this arrangement enhances the focus on overall risk management and the long-term success of the Bank.

Senior Officers Compensation Discussion and Analysis

CoBank, ACB

Summary Compensation Table

Compensation earned by our chief executive officer and aggregate compensation of other senior officers for the years ended December 31, 2010, 2009 and 2008 is disclosed in the accompanying table. Disclosure of the total compensation paid during 2010 to any designated senior officer is available to shareholders upon request. Our current Board policy regarding reimbursements for travel, subsistence and other related expenses states that all employees, including senior officers, shall be reimbursed for actual reasonable travel and related expenses that are necessary and that support our business interests. A copy of our policy is available to shareholders upon request.

Summary Compensation Table ¹ (\$ in Thousands)

| Name of Individual or Number in Group ² | Year | Annual | | | | | | | Total |
|---|------|----------|--|---|-------------------------|-----------------------------------|--------------------|------|----------|
| | | Salary | Short-Term Incentive Compensation ^{3,4} | Long-Term Incentive Compensation ³ | Change in Pension Value | Deferred/Perquisites ⁵ | Other ⁶ | | |
| President & CEO: | | | | | | | | | |
| Robert B. Engel | 2010 | \$ 596 | \$ 1,148 | \$ 1,409 | \$ 1,008 | \$ 93 | \$ - | \$ - | \$ 4,254 |
| Robert B. Engel | 2009 | 575 | 982 | 1,188 | 1,432 | 124 | - | - | 4,301 |
| Robert B. Engel | 2008 | 562 | 1,495 | 856 | 1,137 | 97 | - | - | 4,147 |
| Aggregate Number of Senior Officers (excluding the CEO): | | | | | | | | | |
| 8 | 2010 | \$ 2,271 | \$ 1,934 | \$ 1,587 | \$ 1,473 | \$ 276 | \$ 1,417 | \$ - | \$ 8,958 |
| 9 | 2009 | 2,342 | 2,326 | 2,388 | 1,320 | 444 | 2,630 | - | 11,450 |
| 8 | 2008 | 1,856 | 2,999 | 1,634 | 1,368 | 267 | - | - | 8,124 |

¹ Compensation amounts do not include earnings on nonqualified deferred compensation, as such earnings are not considered above-market or preferential.

² The senior officers included in the summary compensation disclosure are those officers defined by FCA regulation §619.9310.

³ Incentive compensation amounts represent amounts earned in the reported fiscal year, which are paid in March of the subsequent year to persons who continue to be employed by CoBank or unless otherwise provided for in an employment agreement. The short-term incentive compensation amounts are calculated based on relevant performance factors for the reported fiscal year, while the long-term incentive compensation amounts are calculated based on the relevant performance factors for the three-year performance period ended in the reported fiscal year.

⁴ As described on page 124, 2009 short-term incentive payments were reduced to reflect the costs related to the settlement of a business dispute in early 2010. Individual performance factors were also reduced for certain senior officers in 2009 and 2010.

⁵ Represents company contributions to a 401(k) retirement savings plan and nonqualified deferred compensation plan, as well as payment of tax return preparation and financial planning expenses, relocation, certain travel-related expenses, wellness benefits and associated income tax impact.

⁶ For 2010, represents amounts paid or payable to two senior officers (who left the Bank in 2010) for employment transition and separation pay, salary continuance and certain other benefits. For 2009, includes \$2,270 payable to a senior officer (who left the Bank in 2009) for salary continuance, incentive compensation and certain other benefits, all pursuant to the terms of an employment agreement, and \$360 for a one-time sign-on payment to a senior officer for accepting employment with the Bank in that period.

Senior Officers Compensation Discussion and Analysis

CoBank, ACB

Pension Benefits

The table below shows the present value of accumulated benefits payable to the President and CEO by plan, including the number of years of credited service.

Pension Benefits Table (\$ in Thousands)

| Plan Name | Number of Years of Credited Service | Actuarial Present Value of Accumulated Benefits | Payments During Last Fiscal Year |
|--|--|--|---|
| CoBank, ACB Retirement Plan | 10.58 | \$ 297 | \$ - |
| Supplemental Executive Retirement Plan | 10.58 | 1,559 | - |
| Executive Retirement Plan | 10.58 | 4,732 | - |
| Total | | \$ 6,588 | \$ - |

Report on Compensation

CoBank, ACB

Members of the Compensation Committee of the Board of Directors are appointed by the Board chair in consultation with the Board officers and committee chairs. All members of the Compensation Committee qualify as independent directors as defined by Board policy.

The Compensation Committee (Committee) establishes the total compensation philosophy at the Bank utilizing an independent, Committee-appointed, executive compensation consultant, which includes establishing compensation policies, short- and long-term incentive compensation plans and employee benefits. In so doing, the Committee has developed and implemented compensation policies and programs that support the Bank's core values and links compensation to overall Bank and individual performance, ensuring a proper balance with the risk profile of the Bank, thereby contributing to the value of the shareholders' investment in the Bank.

The Committee is responsible for establishing the performance standards for the President and Chief Executive Officer and the compensation structure for other associates of the Bank. The Committee reviews and recommends for full Board approval all aspects of compensation (base salary, short- and long-term incentives, benefits, and perquisites) for the President and Chief Executive Officer, consistent with the business and financial objectives of the Bank, the results achieved by the executive, and competitive compensation practices. The Committee operates under a written charter, adopted by the Committee and the Board of Directors, which more fully describes the Committee's responsibilities.

The Committee has reviewed and discussed the Senior Officers Compensation Discussion and Analysis with management. Based on this review and discussion, the Committee recommended to the Board of Directors, and the Board approved, that the Senior Officers Compensation Discussion and Analysis be included in the Annual Report for the year ended December 31, 2010.

Members of the Compensation Committee:

Everett Dobrinski, Chair
Mary E. Fritz
William H. Harris
Daniel T. Kelley
James A. Kinsey
Robert D. Nattier

March 1, 2011

Code of Ethics

CoBank, ACB

CoBank sets high standards for honesty, ethics, integrity, impartiality and conduct. Each year, every associate certifies compliance with the letter, intent and spirit of our Associate Responsibilities and Conduct Policy, which establishes the ethical standards of our organization, and each senior officer is required to disclose additional information. Additionally, our president and chief executive officer, chief operating officer, chief risk officer, chief credit officer, chief financial officer and other senior financial professionals certify compliance with the letter, intent and spirit of our Code of Ethics. Our Code of Ethics supplements our Associate Responsibilities and Conduct Policy and establishes additional responsibilities specifically related to the preparation and distribution of our financial statements and related disclosures. Details about our Code of Ethics are available at www.cobank.com. At your request, we will provide you with a copy of our Code of Ethics, free of charge. Please contact:

Corporate Communications Division
P. O. Box 5110
Denver, CO 80217
(303) 740-4061

Young, Beginning, and Small Farmers

CoBank, ACB

We believe the future of agriculture and rural America will be better served if loan programs are developed by Associations to aid ambitious and capable young, beginning, and small farmers. Therefore, we have adopted a written policy that encourages the board of directors at each of our affiliated Associations to establish a program to provide sound and constructive credit and other services to young, beginning, and small farmers and ranchers and producers or harvesters of aquatic products (YBS farmers and ranchers). Each Association provides us annually with a report measuring achievement with respect to these programs for YBS farmers and ranchers. A summary of the combined reports for our affiliated Associations and certain participations CoBank purchased from Associations follows.

YBS Farmers and Ranchers (\$ in Thousands)

| | Loan Numbers | | Loan Volume | |
|---|--------------|----------------------|--------------|----------------------|
| | Number | Percent of Portfolio | Dollars | Percent of Portfolio |
| Loans and Commitments Outstanding at December 31, 2010: | | | | |
| Young | 9,491 | 17.91 % | \$ 2,554,170 | 11.78 % |
| Beginning | 12,883 | 24.31 | 2,980,607 | 13.75 |
| Small | 26,424 | 49.86 | 3,224,143 | 14.87 |
| Gross New Loans and Commitments Made During 2010: | | | | |
| Young | 2,401 | 13.14 % | \$ 738,715 | 10.60 % |
| Beginning | 3,858 | 21.11 | 825,525 | 11.85 |
| Small | 11,766 | 64.37 | 1,073,158 | 15.40 |

Small Farmers and Ranchers

Number / Volume of Loans Outstanding by Loan Size at December 31, 2010

| Number / Volume | \$0 – | \$50,001 – | \$100,001 – | \$250,001 |
|---|------------|------------|-------------|--------------|
| | \$50,000 | \$100,000 | \$250,000 | and greater |
| Total Number of Loans to Small Farmers and Ranchers | 13,901 | 5,646 | 4,738 | 2,139 |
| Total Loan Volume to Small Farmers and Ranchers (\$ in Thousands) | \$ 277,912 | \$ 417,209 | \$ 731,429 | \$ 1,797,593 |

Key definitions are as follows:

Young Farmer and Rancher – A farmer, rancher or producer or harvester of aquatic products who is age 35 or younger as of the date the loan was originally made.

Beginning Farmer and Rancher – A farmer, rancher or producer or harvester of aquatic products who has 10 years or less of experience at farming, ranching or producing or harvesting aquatic products as of the date the loan was originally made.

Small Farmer and Rancher – A farmer, rancher or producer or harvester of aquatic products who normally generates less than \$250,000 in annual gross sales of agricultural or aquatic products at the date the loan was originally made.

The Young, Beginning, and Small farmer and rancher categories are not mutually exclusive, therefore, certain farmers and ranchers may be classified in more than one category in the tables above.

As a supplement to the YBS program, CoBank has additional programs to make mission-related and other investments that support lending in rural America to operations with farm resources, farm-related expertise and good business plans, but limited access to capital. Such programs have been successful in attracting quality farm operations, meeting the intended purpose of providing vital capital to start-up farming operations and promoting the flow of capital into rural areas.

CERTIFICATION

I, Robert B. Engel, President and Chief Executive Officer of CoBank, ACB (CoBank or the Bank), a federally chartered instrumentality under the Farm Credit Act of 1971, as amended, certify that:

- (1) I have reviewed this annual report of CoBank;
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of CoBank as of, and for, the periods presented in this report;
- (4) CoBank's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for CoBank and have:
 - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Bank, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. evaluated the effectiveness of the Bank's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. disclosed in this report any change in the Bank's internal control over financial reporting that occurred during the Bank's most recent fiscal quarter (the Bank's fourth fiscal quarter in the case of this annual report) that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting; and
- (5) CoBank's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Bank's auditors and the audit committee of the Bank's Board of Directors (or persons performing the equivalent functions):
 - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize, and report financial information; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the Bank's internal control over financial reporting.

/s/ ROBERT B. ENGEL

Robert B. Engel
President and Chief Executive Officer

Dated: March 1, 2011

CERTIFICATION

I, David P. Burlage, Chief Financial Officer of CoBank, ACB (CoBank or the Bank), a federally chartered instrumentality under the Farm Credit Act of 1971, as amended, certify that:

- (1) I have reviewed this annual report of CoBank;
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of CoBank as of, and for, the periods presented in this report;
- (4) CoBank's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for CoBank and have:
 - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Bank, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. evaluated the effectiveness of the Bank's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. disclosed in this report any change in the Bank's internal control over financial reporting that occurred during the Bank's most recent fiscal quarter (the Bank's fourth fiscal quarter in the case of this annual report) that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting; and
- (5) CoBank's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Bank's auditors and the audit committee of the Bank's Board of Directors (or persons performing the equivalent functions):
 - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize, and report financial information; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the Bank's internal control over financial reporting.

/s/ DAVID P. BURLAGE

David P. Burlage
Chief Financial Officer

Dated: March 1, 2011

Leadership

CoBank, ACB

Robert B. Engel, President and Chief Executive Officer

Mary E. McBride, Chief Banking Officer

John C. Holsey, Deputy Chief Banking Officer

Agribusiness

Amy H. Gales, Regional Agribusiness Banking Group*

Robert E. Egerton, Agribusiness Division – East

Mark C. Nonnenmacher, Agribusiness Division – West

Lynn M. Scherler, Agribusiness Division – South

Jonathan B. Logan, Corporate Agribusiness Banking Group

Manuel Fernandez-Quevedo, International Division

Rural Infrastructure

Paul A. Narduzzo, Rural Infrastructure Banking Group

Jennifer G. Goss, Electric Distribution Banking Division

Aivars (Jake) Udris, Energy and Water Banking Division

Robert F. West, Communications Banking Division

Banking Services

Antony M. Bahr, Banking Services Group

Brian J. Klatt, Capital Markets Division

Russell D. Nelson, Farm Credit Leasing Services Corporation**

Candace A. Roper, Knowledge Exchange Division

Richard A. Scholz, Non-Credit Services Division

Ann E. Trakimas, Chief Operating Officer

Finance

David P. Burlage, Chief Financial Officer

Timothy D. Steidle, Treasury Division

Michael R. Vestal, Controller Division

Corporate Services

John Svisco, Chief Administrative Officer

James R. Bernsten, Chief Information Officer

Arthur C. Hodges, Jr., Corporate Communications Division

Robert L. O'Toole, Human Resources Division

Todd E. Wilson, Operations Division

Regulatory, Legislative and Compliance

Andrew D. Jacob, Regulatory, Legislative and Compliance

L. Todd VanHoose, Legislative and Regulatory Affairs

Douglas E. Wilhelm, Chief Risk Officer

Rodney A. Brown, Asset Review Division

Gary M. Fitzgerald, Internal Audit Division

Andrew J. Romanow, Deputy General Counsel

Lori L. O'Flaherty, Chief Credit Officer

Daniel L. Key, Credit Approval Division

* The Strategic Relationships operating segment is included in the Regional Agribusiness Banking Group.

** Farm Credit Leasing Services Corporation is included in our Agribusiness operating segment.

Customer Privacy

Your financial privacy and the security of your other non-public information are important to us. We, therefore, hold your financial and other non-public information in strictest confidence. Federal regulations allow disclosure of such information by us only in certain situations. Examples of these situations include law enforcement or legal proceedings or when such information is requested by a Farm Credit System institution with which you do business. In addition, as required by Federal laws targeting terrorism funding and money laundering activities, we collect information and take actions necessary to verify your identity.

CoBank's 2011 Quarterly and Annual Reports to Shareholders are available free of charge on request by calling or visiting one of our banking center locations and through our website at www.cobank.com on approximately May 10, 2011, August 9, 2011, November 9, 2011, and March 1, 2012 (Annual Report).

OFFICE LOCATIONS

COBANK NATIONAL OFFICE AND DENVER BANKING CENTER

5500 South Quebec Street
Greenwood Village, CO 80111
P.O. Box 5110
Denver, CO 80217
(303) 740-4000
(800) 542-8072

FARM CREDIT LEASING SERVICES CORPORATION

600 Highway 169 South, Suite 300
Minneapolis, MN 55426
(952) 417-7800
(800) 444-2929

WASHINGTON, D.C. OFFICE

50 F Street, N.W., Suite 900
Washington, DC 20001
(202) 879-0838

U.S. REGIONAL OFFICES

AMES BANKING CENTER
2515 University Boulevard, Suite 104
Ames, IA 50010
(515) 292-8828

ATLANTA BANKING CENTER **
900 Circle 75 Parkway, Suite 1400
Atlanta, GA 30339-5946
(770) 618-3200
(800) 255-7429
FCL: (770) 618-3226

AUSTIN BANKING CENTER
4801 Plaza on the Lake Drive
Austin, TX 78746
(512) 483-9273

CALIFORNIA FARM CREDIT LEASING OFFICE *
2345 East Earhart Avenue
Stockton, CA 95206
P.O. Box 31990
Stockton, CA 95213
(209) 944-7478

ENFIELD BANKING CENTER **
240B South Road
Enfield, CT 06082-4451
(860) 814-4043
(800) 876-3227
FCL: (860) 814-4049

FARGO BANKING CENTER
Goldmark Office Park
1711 Gold Drive South, Suite 230
Fargo, ND 58103
(701) 277-5007
(866) 280-2892

LOUISVILLE BANKING CENTER **
1601 UPS Drive, Suite 102
Louisville, KY 40223
(502) 423-5650
(800) 262-6599
FCL: (800) 942-3309

LUBBOCK BANKING CENTER **
5715 West 50th
Lubbock, TX 79414
P.O. Box 6770
Lubbock, TX 79493
(806) 788-3700
FCL: (800) 444-2929

MARYLAND FARM CREDIT LEASING OFFICE *
6546 MidAtlantic Lane
Salisbury, MD 21804
(800) 225-8325

MINNEAPOLIS BANKING CENTER **
600 Highway 169 South, Suite 300
Minneapolis, MN 55426
(952) 417-7900
(800) 282-4150
FCL: (800) 444-2929

**NORTH CAROLINA FARM CREDIT
LEASING OFFICE ***
146 Victory Lane
Statesville, NC 28625
(443) 452-8666

OMAHA BANKING CENTER **
11422 Miracle Hills Drive, Suite 300
Omaha, NE 68154-4404
(402) 492-2000
(800) 346-5717

PENNSYLVANIA FARM CREDIT LEASING OFFICE *
900 Bent Creek Boulevard
Mechanicsburg, PA 17050
(717) 620-2601

SACRAMENTO BANKING CENTER **
1478 Stone Point Drive, Suite 450
Roseville, CA 95661
(916) 380-3524
(800) 457-0942
FCL: (800) 289-7080

SPokane BANKING CENTER
1700 South Assembly Street, Suite 103
Spokane, WA 99224-2121
P.O. Box 2720
Spokane, WA 99220-2720
(509) 363-8700
(800) 378-5577

ST. LOUIS BANKING CENTER **
1650 Des Peres Road, Suite 120
St. Louis, MO 63131
(314) 835-4200
(800) 806-4144
FCL: (800) 853-5480

WICHITA BANKING CENTER **
245 North Waco, Suite 230
Wichita, KS 67202
P.O. Box 2940
Wichita, KS 67201-2940
(316) 290-2000
(800) 322-3654
FCL: (800) 322-6558

* Farm Credit Leasing office only

** Farm Credit Leasing office within
this CoBank location

INTERNATIONAL SINGAPORE REPRESENTATIVE OFFICE

10 Hoe Chiang Road
#05-01 Keppel Towers
Singapore 089315
(65) 6534-5261



5500 SOUTH QUEBEC STREET, GREENWOOD VILLAGE, CO 80111 | 800-542-8072