FEDERAL FINANCING BANK

Financial Statements

September 30, 2008 and 2007

(With Independent Auditors' Report Thereon)

FEDERAL FINANCING BANK

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FEDERAL FINANCING BANK

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Introduction

The Federal Financing Bank (the Bank) is a government corporation under the general supervision and direction of the Secretary of the Treasury. It was created by the Congress in 1973, at the request of the U.S. Department of the Treasury (Treasury). The Bank actively borrows from Treasury and lends to Federal agencies and private borrowers that have Federal guarantees. The Bank also has a debt obligation to the Civil Service Retirement and Disability Fund.

Mission

The mission of the Bank is to reduce the costs of Federal and federally assisted borrowings, to coordinate such borrowings with the Government's overall fiscal policy, and to ensure that such borrowings are done in ways that least disrupt private markets. To accomplish this mission, the Bank exercises its broad statutory authority to purchase obligations issued, sold, or guaranteed by Federal agencies.

Objectives

The Bank was formed to be the vehicle through which Federal agencies finance programs involving the sale or placement of credit market instruments, including agency securities, guaranteed obligations, participation agreements, and the sale of assets. This principle is applied in a manner consistent with the Federal Financing Bank Act of 1973 (12 U.S.C. 2281 et seq.) and its legislative history. Guaranteed programs entailing large numbers of relatively small loans in which local origination and servicing are an integral part of the program are excluded.

The Bank makes funds available to Federal agencies and to guaranteed borrowers in accordance with program requirements. The Bank is capable of providing a lending rate for any amount required and for nearly any maturity. The rates charged by the Bank for terms such as prepayment provisions, forward interest rate commitments, and pass-through of service charges are applied consistently for all borrowers.

The lending policy of the Bank is flexible enough to preclude the need for any accumulation of pools of funds by agencies. This does not exclude the maintenance of liquidity reserves for those agencies that have such a need. In no case will funds provided by the Bank be invested in private credit instruments or be used to speculate in the market for public securities.

Organizational Structure

The Bank is subject to the general supervision and direction of the Secretary of the Treasury. The Board of Directors is comprised of the incumbents of the following Treasury offices: the Secretary of the Treasury, who as provided by law, is the Chairman; the Deputy Secretary; the Under Secretary for Domestic Finance; the General Counsel; and the Fiscal Assistant Secretary.

The officers are incumbents of the following Treasury offices (corresponding Bank positions are in parentheses): the Under Secretary for Domestic Finance (President); the General Counsel (General Counsel); the Assistant Secretary for Financial Markets (Vice President); the Fiscal Assistant Secretary (Vice President); the Deputy Assistant Secretary for Government Financial Policy (Vice President and Treasurer); and the Director, Office of Federal Lending (Secretary and Chief Financial Officer). A delegation by the Bank President authorizes any Bank Vice President, in consultation with any other Bank officer, to exercise the powers of the Presidency.

The staff of the Bank is organized into three units: loan administration, accounting and computer support. The loan administration and accounting managers and the Chief Information Officer (CIO) report to the Chief Financial Officer (CFO). The loan administration manager is responsible for the loan administration unit, which includes the duties and responsibilities associated with credit analysis, loan origination, loan structuring, and customer service. The accounting manager heads a team of professionals responsible for loan disbursements, repayments, accounting and financial reporting. The CIO is responsible for a team of information systems professionals and contractors that conduct in-house software development and maintain the Bank's Oracle-based mission critical enterprise application. That application provides systems support for the loan administration and accounting functions.

Ongoing Issues

Title XVII of the Energy Policy Act of 2005 created a loan guarantee program to be administered by the Department of Energy for innovative technologies. This program will finance guaranteed loans through the Bank. The initial loans are expected to be guaranteed during the first quarter of fiscal year (FY) 2009. Congress has authorized $42 billion of loan guarantees for the Title XVII loan guarantee program.

Title IV, the Home Ownership Preservation Entity (HOPE) Fund for Homeowners Act of 2008, of the Housing and Recovery Act of 2008, authorizes the Secretary of the Treasury to issue HOPE bonds without any limitations as to the purchaser of the issuance. Due to the cost of issuing special purpose bonds to the public, the Secretary of the Treasury has decided to issue the HOPE bonds to the Bank. The total outstanding HOPE bonds may not exceed $300 billion. The purchase of HOPE bonds is consistent with the core mission of the Bank.

Under a provision in the 1987 enabling legislation for the U.S. Department of Agriculture's Rural Utilities Services (RUS) Cushion of Credit Payments Program (cushion of credit), the Bank receives considerably less interest each year on certain RUS loans that it holds than it is contractually entitled to receive. This provision, however, did not reduce the amount of interest the Bank owed on its corresponding loans from Treasury. The shortfall in interest received by the Bank has resulted in substantial deficits in the past. The cumulative losses from interest credits taken by the RUS, beyond losses that were extinguished by appropriation in a previous year, totaled $1,199,275 thousand through September 30, 2008. The interest shortfall is recorded on the statement of operations and changes in net position as legislatively-mandated interest credit (contra-revenue to interest on loans). In September 2007, the Bank prepaid all corresponding loans owed to Treasury that financed the RUS loans affected by the cushion of credit.

Section 774 of the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2006, also known as the Final Maturity Extension Authority, amended the Rural Electrification Act of 1936 by adding a new section permanently authorizing maturity extensions for RUS-guaranteed Bank loans. The Final Maturity Extension Authority allows borrowers of loans made by the Bank and guaranteed by RUS to request an extension of the final maturity of the outstanding principal balance of their RUS-guaranteed Bank loans. In 2008, as authorized under the Final Maturity Extension Authority, the Bank extended the final maturity date for two borrowers that participated in the new program, the Oglethorpe Power Association and North Carolina Electric Membership Corporation.

The Balanced Budget and Emergency Deficit Control Act of 1985, commonly known as Gramm-Rudman-Hollings, Consolidated Omnibus Budget Reconciliation Act of 1985 and the Federal Credit

Reform Act of 1990 included provisions that have acted as prohibitions and disincentives against the Bank financing of certain loans that are 100 percent guaranteed by Federal agencies.

Section 6102 of the Food, Conservation, and Energy Act of 2008 reinstated the direct loan program for the RUS Electric Program, eliminating the borrower's right to have loans financed by the Bank. Beginning in FY 2010, RUS anticipates financing new electric loans through the direct loan program instead of financing the loans through the Bank.

Impact of Economic Conditions

Current economic conditions have had an impact on programs that borrow from the Bank. Certain programs have borrowed more than they anticipated, which has increased the amount of loans outstanding from the Bank. Additionally, new legislation passed by Congress has changed and will change the Bank's asset holdings.

Financial Highlights

Statements of Operations and Changes in Net Position Highlights

The following is a synopsis of the financial performance of the Bank for the fiscal year ended September 30, 2008. Interest on loans of $1,941,407 thousand for the fiscal year ended September 30, 2008 decreased compared to the interest on loans of $1,977,872 thousand for the fiscal year ended September 30, 2007 due to lower market interest rates. The legislatively-mandated interest credits reduced interest income by $97,998 thousand and $97,830 thousand for the fiscal years ended September 30, 2008 and 2007, respectively, and are related to RUS "cushion of credit" loans. Revenue from servicing loans of $3,328 thousand for the fiscal year ended September 30, 2008, was relatively unchanged from $3,299 thousand for the fiscal year ended September 30, 2007.

Interest on borrowings of $1,237,371 thousand for the fiscal year ended September 30, 2008 decreased from the interest on borrowings of $1,277,987 thousand for the fiscal year ended September 30, 2007 due to lower market interest rates. After the administrative expenses of $5,713 thousand, net income of $603,696 thousand for the fiscal year ended September 30, 2008 increased from the net income of $600,636 thousand for the fiscal year ended September 30, 2007.

Statements of Financial Position Highlights

Funds with U.S. Treasury (cash equivalents) amounted to $744,393 thousand at September 30, 2008, which represents an increase from the September 30, 2007 balance of $228,114 thousand. The increase is due to the net income for fiscal year 2008. In August 2008, the Bank made early repayments to the Treasury for $1,065,047 thousand, resulting in a loss of $65,047 thousand. In September 2007, the Bank made early repayments to the Treasury for $1,928,326 thousand, resulting in a net gain of $10,572 thousand. The repayments represent capital transactions with Treasury.

The loan portfolio (loans receivable) increased $4,484,746 thousand from $33,992,122 thousand at September 30, 2007 to $38,476,868 thousand at September 30, 2008. The change is primarily the result of a $3,000,000 thousand increase in short-term loans to the U. S. Postal Service, and new short-term loans of $1,100,000 thousand to the National Credit Union Administration. The Bank's net position increased to

$2,903,686 thousand at September 30, 2008 from $2,365,037 thousand at September 30, 2007, primarily as a result of positive earnings.

All of the loans in the Bank's portfolio are federally guaranteed, except for those of the U.S. Postal Service. The Bank does not maintain a reserve for loan losses as no future credit-related losses are expected.

Performance Highlights

During fiscal year 2008, the Bank processed 522 new loan requests. The interest rate was set or reset on 1,253 loans in fiscal year 2008 for new loans and maturity extensions. The Bank processed 224 prepayments and 30,456 loan payments in fiscal year 2008.

Management Controls

The Bank completed an in-depth testing of its internal accounting and administrative control procedures in accordance with OMB Circular No. A-123, *Management's Responsibility for Internal Control*, in July 2008. Additionally, in fiscal year 2006, a private contractor performed a certification and accreditation of the Bank's enterprise management system, known as the Loan Management Control System, which is effective for three years.

Accordingly, we believe that the Bank's systems of internal accounting and administrative controls fully comply with the requirements for agency internal accounting and administrative control systems, providing reasonable assurance that they are achieving the intended objectives.

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Independent Auditors' Report on Financial Statements

Inspector General, U.S. Department of the Treasury and the Board of Directors, Federal Financing Bank:

We have audited the accompanying statements of financial position of the Federal Financing Bank (the Bank) as of September 30, 2008 and 2007, and the related statements of operations and changes in net position and cash flows for the years then ended (hereinafter referred to as financial statements). These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes 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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Federal Financing Bank as of September 30, 2008 and 2007, and the results of its operations, and cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

The information in the Management's Discussion and Analysis section is presented for the purpose of additional analysis and is not required as part of the financial statements. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The other supplementary information included in Schedule 1 is presented for purposes of additional analysis and is not required as part of the financial statements. This information has not been subjected to auditing procedures and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 10, 2008, on our consideration of the Bank's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our audits.

KPMG LLP

November 10, 2008

FEDERAL FINANCING BANK

Statements of Financial Position

September 30, 2008 and 2007

(Dollars in thousands)

Assets		2008	2007
Funds with U.S. Treasury	$	744,393	228,114
Investments held-to-maturity (fair value of $29,585 and $0, notes 2 and 5)		29,535	—
Loans receivable (notes 3, 5, and 8)		38,476,868	33,992,122
Accrued interest receivable		182,884	451,930
Advances to others		92	658
Total assets	$	39,433,772	34,672,824
Liabilities and Net Position			
Liabilities:			
Borrowings:			
Principal amount	$	36,036,419	31,620,998
Plus unamortized premium		287,953	348,111
Total borrowings (notes 4, 5, and 8)		36,324,372	31,969,109
Accrued interest payable		205,534	338,529
Other liabilities		180	149
Total liabilities		36,530,086	32,307,787
Loan commitments (note 9)			
Net position (note 6)		2,903,686	2,365,037
Total liabilities and net position	$	39,433,772	34,672,824

See accompanying notes to financial statements.

FEDERAL FINANCING BANK

Statements of Operations and Changes in Net Position

Years ended September 30, 2008 and 2007

(Dollars in thousands)

		2008	2007
Revenue and financing sources:			
Interest on loans	$	1,941,407	1,977,872
Less legislatively-mandated interest credit		(97,998)	(97,830)
Net interest on loans		1,843,409	1,880,042
Interest on investments		43	—
Revenue from servicing loans		3,328	3,299
Total revenue		1,846,780	1,883,341
Expenses:			
Interest on borrowings		1,237,371	1,277,987
Administrative expenses		5,713	4,718
Total expenses		1,243,084	1,282,705
Net income	$	603,696	600,636
Net position:			
Beginning of year	$	2,365,037	1,753,829
Net income		603,696	600,636
(Loss) gain on extinguishment of borrowings treated as capital transactions (note 7)		(65,047)	10,572
End of year (note 6)	$	2,903,686	2,365,037

See accompanying notes to financial statements.

FEDERAL FINANCING BANK

Statements of Cash Flows

Years ended September 30, 2008 and 2007

(Dollars in thousands)

		2008	2007
Cash flows from operations:			
Net income	$	603,696	600,636
Adjustments to reconcile net income to net cash provided by operations:			
Amortization of premium on loans		(60,158)	(57,591)
Capitalization of interest receivable		(111)	(1,150)
Capitalization of interest payable		83,022	94,322
Decrease (increase) in accrued interest receivable		269,046	(6,231)
Decrease (increase) in advances to others		566	(375)
(Decrease) increase in accrued interest payable		(132,995)	16,199
Increase in other liabilities		31	20
Net cash provided by operations		763,097	645,830
Cash flows from investing activities:			
Investment purchases		(29,535)	—
Loan disbursements		(95,961,408)	(15,397,941)
Loan collections		91,476,773	13,250,542
Net cash used in investing activities		(4,514,170)	(2,147,399)
Cash flows from financing activities:			
Borrowings		95,990,943	15,397,941
Repayments of borrowings		(91,723,591)	(14,569,738)
Net cash provided by financing activities		4,267,352	828,203
Net increase (decrease) in cash		516,279	(673,366)
Funds with U.S. Treasury – beginning of the period		228,114	901,480
Funds with U.S. Treasury – end of the period	$	744,393	228,114
Supplemental disclosures of cash flow information:			
Interest paid (net of amount capitalized)	$	1,344,743	1,239,045
Supplemental schedule of noncash investing and financing activities:			
(Loss) gain on early extinguishment of borrowings treated as capital transactions (note 7)	$	(65,047)	10,572

See accompanying notes to financial statements.

(1) Summary of Significant Accounting Policies

The Federal Financing Bank (the Bank) was created by the Federal Financing Bank Act of 1973 (12 USC 2281, the Act) as an instrumentality of the U. S. Government and a body corporate under the general supervision of the Secretary of the Treasury (the Secretary). The budget and audit provisions of the Government Corporation Control Act are applicable to the Bank in the same manner as they are applied to other wholly owned government corporations.

The Bank was established by Congress at the request of the U.S. Department of the Treasury (Treasury), in order "to assure coordination of Federal and federally assisted borrowing programs with the overall economic and fiscal policies of the U. S. Government, to reduce the cost of Federal and federally assisted borrowing from the public, and to assure that such borrowings are financed in a manner least disruptive of private financial markets and institutions." The Bank was given broad statutory authority to finance obligations issued, sold, or guaranteed by Federal agencies so that the Bank could meet these debt management objectives.

The Bank is authorized to issue obligations to the public in amounts not to exceed $15,000,000 with the approval of the Secretary. Additionally, the Bank is authorized to issue obligations in unlimited amounts to the Secretary and, at the discretion of the Secretary, may agree to purchase any such obligations.

(a) Basis of Presentation

The Bank has historically prepared its financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP), based on standards issued by the Financial Accounting Standards Board (FASB), the private-sector standards-setting body. In October 1999, the American Institute of Certified Public Accountants (AICPA) designated the Federal Accounting Standards Advisory Board (FASAB) as the standards-setting body for the establishment of accounting principles generally accepted in the United States of America with respect to the financial statements of Federal government entities. The FASAB has indicated that financial statements prepared based upon standards promulgated by the FASB may also be regarded as in accordance with GAAP for those Federal entities, such as the Bank, that have issued financial statements based upon FASB standards in the past. Accordingly, consistent with historical reporting, the Bank's financial statements are presented in accordance with accounting and financial reporting standards promulgated by the FASB.

(b) Basis of Accounting

The financial statements are presented on the accrual basis of accounting. The Bank recognizes loans when they are issued and related repayments when they are received. The Bank recognizes borrowings when they are received and repayments when they are made. In addition, the Bank recognizes interest on loans, interest on investments, and revenue from servicing loans when they are earned and recognizes interest on borrowings and expenses when they are incurred.

(c) Funds with U.S. Treasury

As a government corporation, the Bank maintains a Fund Balance with Treasury (fund account 20X4521) and does not hold cash. For the purposes of the statements of cash flows, the funds with Treasury are considered cash.

(d) Investments

The Bank's investments at September 30, 2008 consist of investments in U. S. Treasury securities for the Home Ownership Preservation Entity (HOPE) Fund. The securities are categorized as held-to-maturity, because the Bank has the ability and intent to hold the securities until maturity. The securities are recorded at par value.

(e) Loans Receivable

The Bank issues loans to Federal agencies for their own use or to issue loans to private sector borrowers, whose loans are guaranteed by the Federal agencies. When a Federal agency has to honor its guarantee because a private sector borrower defaults, the Federal agency must obtain an appropriation or use other resources to pay the Bank. Loan principal and interest are backed by the full faith and credit of the U.S. Government, except for loans to the U.S. Postal Service. The Bank has not incurred and does not expect to incur any credit-related losses on its loans.

(f) Interest on Loans

The Bank's general policy is to capture the liquidity premium between Treasury securities and the private sector lending rates, and to charge a rate that reflects the risk inherent in a borrower or transaction, when such a rate will accomplish a broader goal. The income resulting from the interest spread covers the administrative expenses of the Bank and any surplus is transferred to the Treasury's General Fund. Under amendments to the Federal Credit Reform Act, effective October 1, 1998, while the Bank is permitted to charge a spread on new lending arrangements with government-guaranteed borrowers, the margin is not retained by the Bank, but rather is retained by the loan guarantor. In the event that this results in the Bank being unable to fund its administrative expenses related to these loans, the Federal Credit Reform Act, as amended, states that the Bank may require reimbursement from loan guarantors.

(g) Capitalized Interest

In accordance with their loan agreements with the Bank, the General Services Administration (GSA), Historically Black Colleges and Universities (HBCU) and Veteran Administration Transitional Housing (VATH) have the option of deferring payments of interest on their loans until future periods. When GSA, HBCU or VATH elect, in advance, to defer interest payments, the accrued interest is recorded as capitalized interest receivable and added to the respective loan balance by the Bank. The Bank correspondingly capitalizes the interest payable on its related borrowings.

(Continued)

(h) Premium on Borrowings

The Bank amortizes the premium on borrowings using the effective interest method. The amortization is recorded as part of interest on borrowings on the statements of operations and changes in net position.

(i) Legislatively-mandated Interest Credit

In prior years, the Bank purchased certificates of beneficial ownership (i.e., loans reported as loans receivable on the statement of financial position) from RUS, a component of the U.S. Department of Agriculture. RUS used the funds received from the Bank to issue loans to nonfederal entities, specifically private utility companies. In 1987, Congress passed legislation (i.e., 7 USC Sec. 940c - Cushion of Credit Payments Program) that required RUS to develop and promote a program to encourage private utility companies to voluntarily make deposits into cushion of credit accounts established within RUS. The legislation also indicated that private utility companies may reduce the balance of their cushion of credit account only if the reduction is used to make scheduled payments on loans received from RUS. In accordance with the legislation, the private utility companies accrue interest at the higher of 5% per annum or the weighted average rate of the certificates of beneficial ownership on cash deposited into the cushion of credit accounts with RUS. The legislation also indicated that RUS shall receive an interest credit from the Bank equal to the amount of interest RUS pays to the private utility companies. The Bank records the interest credit in the period the cost is incurred as a legislatively-mandated interest credit (contra-revenue to interest on loans) in the statements of operations and changes in net position.

(j) Revenue from Servicing Loans

The Bank charges certain U.S. Department of Agriculture's Rural Utilities Services (RUS) borrowers a loan service fee that is reported as revenue from servicing loans on the statements of operations and changes in net position. The Bank's loan servicing fee is equal to one-eighth of one percent more than the contractual interest rate with Treasury.

(k) Administrative Expenses

The Bank is subject to the general supervision and direction of the Secretary. As provided by law, the Secretary acts as chairman of the board of directors. Employees of Treasury's Departmental Offices perform the Bank's management and accounting functions; its legal counsel is the General Counsel of the Treasury. The Bank reimburses Treasury for the facilities and services it provides. The amounts of such reimbursements are reported as administrative expenses in the statements of operations and changes in net position.

(l) Net Position

The Bank can borrow from Treasury to meet its immediate cash needs and can also seek appropriations from Congress to make up for accumulated losses that will not be met by income.

(Continued)

(m) Loan Commitments

The Bank recognizes loan commitments when the Bank and the other parties fully execute the promissory notes and reduces loan commitments when the Bank issues loans or when the commitments expire. Most obligations of the Bank give a borrower the contractual right to a loan or loans immediately or at some point in the future. The Bank limits the time available for a loan under an obligation, where applicable.

(n) Management's Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

(o) Tax-Exempt Status

The Bank is exempt from tax in accordance with Section 11(a) of the Federal Financing Bank Act of 1973 (12 USC 2281).

(p) Related Parties

The Bank conducts most of its financial transactions with other Federal entities and therefore the financial statement balances that represent transactions with other Federal entities include all assets; liabilities, except borrowings from the public of $10 as of September 30, 2008 and 2007; revenues; and expenses.

(q) Future Accounting Standards

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. SFAS No. 157, *Fair Value Measurements*, is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Bank will adopt the fair value measurements in FY 2009. The Bank is in the process of evaluating the impact that will result from adopting SFAS No. 157.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value and also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Bank will elect to not measure at fair value the Bank's financial assets and liabilities under the optional provisions of SFAS No. 159 that will be effective in FY 2009.

(Continued)

(Dollars in thousands)

(2) Investments Held-to-Maturity (the HOPE bond transaction)

The Secretary is authorized to issue up to $300,000,000 HOPE bonds under the HOPE for Homeowners Act of 2008 and the Secretary has decided to issue the HOPE bonds to the Bank for purchase. The Bank purchased one bond at par value of $29,535 on August 27, 2008, with a floating interest rate to be reset quarterly. The interest rate is 1.600% as of September 30, 2008. The HOPE bond has a 30-year maturity date of August 27, 2038, and interest is due on a quarterly basis. The HOPE bond is reported as investments held-to-maturity and the related interest receivable is reported as accrued interest receivable in the Bank's statements of financial position.

The carrying amount, accrued interest, unrealized holding gains, and fair value of the HOPE bond at September 30, 2008 were as follows:

Investments held-to-maturity	Carrying Amount	Accrued Interest	Unrealized Holding Gains	Fair Value
U.S. Treasury Nonmarketable Securities – HOPE Bond	$ 29,535	43	7	29,585
Total	$ 29,535	43	7	29,585

The Bank borrowed funds from Treasury at the same terms to purchase the HOPE bond.

(3) Loans Receivable

Loans receivable represent the outstanding balances for loans to agencies. The Bank has the ability and intends to hold loans receivable until maturity or payoff. At September 30, 2008, the Bank had outstanding loans receivable of $38,476,868, with interest rates ranging from 0.155% to 16.183%, and maturity dates from October 1, 2008 to July 17, 2045. At September 30, 2007, the Bank had outstanding loans receivable of $33,992,122, with interest rates ranging from 2.501% to 16.183%, and maturity dates from October 1, 2007 to July 17, 2045.

(Continued)

(Dollars in thousands)

Loans receivable at September 30, 2008 and 2007, consist of the following:

Agency		2008	2007
Rural Utilities Service, Department of Agriculture	$	22,693,499	21,687,204
Rural Utilities Service, Department of Agriculture certificates of beneficial ownership (CBO)		3,632,550	3,916,573
General Services Administration		2,097,771	2,151,379
U.S. Postal Service		7,200,000	4,200,000
National Credit Union Administration		1,109,161	—
Foreign Military Sales, Department of Defense		680,365	836,466
Low Rent Public Housing, Department of Housing and Urban Development		691,412	790,624
Historically Black Colleges and Universities, Department of Education		338,466	315,215
Ship Leasing, Department of Defense, Navy		16,623	69,619
Small Business Administration		10,046	16,989
Veteran Administration Transitional Housing Program		4,940	4,990
Federal Railroad Administration, Department of Transportation		2,035	2,269
Virgin Islands, Department of the Interior		—	794
Total loans receivable	$	38,476,868	33,992,122

The loans receivable due within one year are $9,611,426 and $5,556,462 as of September 30, 2008 and 2007, respectively.

(4) Borrowings

Under the FFB Act, the Bank may, with the approval of the Secretary, borrow without limit from the Treasury. Repayments on Treasury borrowings match the terms and conditions of corresponding loans made by the Bank and bear interest at the respective rate as determined by the Secretary. The Bank's borrowings are repayable on demand. At September 30, 2008, the Bank had Treasury borrowings of $22,036,409, with interest rates ranging from .03% to 13.759%, and maturity dates from October 1, 2008 to July 17, 2045. At September 30, 2007, the Bank had Treasury borrowings of $17,620,988, with interest rates ranging from 1.822% to 13.759%, and maturity dates from October 1, 2007 to July 17, 2045.

Additionally, at September 30, 2008 and 2007, the Bank had borrowings of $14,000,000 and an associated unamortized premium of $287,953 and $348,111, respectively, from the Civil Service Retirement and Disability Fund (CSR&DF), which is administered by the Office of Personnel Management (OPM). These borrowings are at stated interest rates ranging from 4.625% to 5.625%, effective interest rate of 4.125%, and with maturity dates ranging from June 30, 2009 to June 30, 2019. Borrowings from the public amounted to $10 at September 30, 2008 and 2007.

(Dollars in thousands)

The scheduled principal repayments below reflect maturities of the Bank's borrowings and do not necessarily match the maturities of assets in the Bank's loan portfolio. Scheduled principal repayments of borrowings as of September 30, 2008, are as follows:

Repayment Date		Amount
2009	$	11,053,619
2010		1,727,743
2011		1,880,988
2012		2,235,398
2013		1,541,550
2014 and thereafter		17,597,121
Total principal payments		36,036,419
Plus unamortized premium		287,953
Total borrowings	$	36,324,372

(5) Fair Value of Financial Instruments and Interest Rate Volatility

The fair value of the Bank's loans receivable, investments, and borrowings changes in response to the interest rate volatility that results from the current economic conditions, market perception and expectations. However, because the interest rates and maturities of loans receivables, investments, and borrowings are very similar, the fair market values of both assets and liabilities increase or decrease in the same direction and in similar amounts.

(a) Funds with U.S. Treasury

The carrying amount approximates fair value because of the liquid nature of the funds with Treasury.

(b) Loans Receivable, Investments, and Borrowings

The fair value of loans receivable, investments, and borrowings is calculated using discounted cash flow analyses based on contractual repayment terms. The discount rates used in the loans receivable and investment analysis are based on interest rates currently being offered by the Bank on loans of similar maturity and other characteristics. The discount rates used in the borrowings analysis are based on interest rates of current borrowings from Treasury using similar maturity and other characteristics. The fair value of loans receivable at September 30, 2008 and 2007 was $42,265,527 and $36,956,776, respectively. The fair value of investments held-to-maturity at September 30, 2008 and 2007 was $29,585 and $0, respectively. The fair value of borrowings at September 30, 2008 and 2007 was $37,817,803 and $32,201,562, respectively.

(c) Advances to Others, Accrued Interest Receivable, Accrued Interest Payable, and Other Liabilities

The carrying amount of advances to others, accrued interest receivable, accrued interest payable, and other liabilities approximate fair value as they represent the amounts expected to be realized or paid and are current assets and liabilities.

(Dollars in thousands)

(6) Net Position

At September 30, 2008 and 2007, the net position includes the following:

		2008	2007
Transfers to Treasury	$	(1,682,847)	(1,682,847)
Cumulative results of operations and gains/losses on early extinguishment of borrowings treated as capital transactions		4,586,533	4,047,884
Net position	$	2,903,686	2,365,037

Included in the net position activity is income the Bank earned prior to fiscal year 2000 that the Bank transferred to Treasury.

(7) Loss/Gain on Extinguishment of Borrowings Treated as Capital Transactions

In September 2008 and 2007, the Bank made early repayments to Treasury totaling $1,069,358 and $1,928,326, resulting in a net loss of $65,047 and in a net gain of $10,572, respectively. These represent capital transactions with Treasury and are respectively reported as a (loss) gain on extinguishment of borrowings treated as capital transactions on the statements of operations and changes in net position.

(8) Capitalized Interest

Capitalized interest receivable was approximately $21,709 and $33,047, and the related capitalized interest payable was $78,572 and $11,285 as of September 30, 2008 and 2007, respectively. Capitalized interest receivable and payable are reported as part of the loans receivable and borrowing balances, respectively, on the statements of financial position.

(9) Loan Commitments

The Bank makes loan commitments to extend credit to Federal program agencies based on the loan agreements executed between the parties. The loan commitments are not reported on the statements of financial position and generally have fixed expiration dates or other termination clauses. Since many of the loan commitments are expected to expire without being completely drawn upon, the total loan commitment amounts do not necessarily represent future cash requirements. The Bank uses the same credit policies in making loan commitments as it does for loans receivable reported on the statements of financial position. The Bank funds the loan commitments with its borrowing authority from the Secretary. There is no exposure or credit risk related to these commitments.

(Continued)

(Dollars in thousands)

The contract amounts and remaining loan commitments by program agency as of September 30, 2008, are as follows:

Agency		Contract amounts	Remaining loan commitments
U.S. Postal Service	$	15,000,000	7,800,000
Rural Utilities Service, Department of Agriculture		11,463,270	3,411,690
National Credit Union Administration		5,000,000	3,890,893
Historically Black Colleges and Universities, Department of Education		464,560	274,793
General Services Administration		193,200	21,312
Total commitments	$	32,121,030	15,398,688

(Continued)

FEDERAL FINANCING BANK

Other Supplementary Information – Schedule 1

Unaudited – See Accompanying Independent Auditors' Report

September 30, 2008 and 2007

(Dollars in thousands)

In prior years, the Federal Financing Bank (Bank) purchased certificates of beneficial ownership (i.e., loans reported as loans receivable on the statement of financial position) from the Rural Utilities Service (RUS), a component of the U.S. Department of Agriculture. RUS used the funds received from the Bank to issue loans to nonfederal entities, specifically private utility companies. In 1987, Congress passed legislation (i.e., 7 USC Sec. 940c - Cushion of Credit Payments Program) that required RUS to develop and promote a program to encourage private utility companies to voluntarily make deposits into cushion of credit accounts established within RUS. The legislation also indicated that a private utility company may reduce the balance of its cushion of credit account only if the reduction is used to make scheduled payments on loans received from RUS. In accordance with the legislation, the private utility companies accrue interest at a rate of 5% per annum or the weighted average rate of the certificates of beneficial ownership on cash deposited into the cushion of credit accounts with RUS. The legislation also indicated that RUS shall receive an interest credit from the Bank equal to the amount of interest RUS pays to the private utility companies. The Bank records the interest credit in the period the cost is incurred as a legislatively-mandated interest credit (contra-revenue to interest on loans) in the statements of operations and changes in net position. As of September 30, 2008, the outstanding principal balance of the 15 RUS loans subject to the certificates of beneficial ownership (CBO) legislation totaled $3,632,550 with interest rates ranging from 7.755% to 15.325%, and maturity dates ranging from 2009 to 2021. In October 1998, the Bank received an appropriation that off-set the RUS-CBO interest credits by $917,699.

The interest credits that the Bank has provided RUS-CBO through September 30, 2008 are as follows:

Fiscal Year		**Interest Credits**
1988–2003	$	1,292,326
2004		150,134
2005		244,420
2006		234,266
2007		97,830
2008		97,988
Total interest credits		2,116,974
Less appropriaton		(917,699)
Total	$	1,199,275

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report on Internal Control Over Financial Reporting

Inspector General, U.S. Department of the Treasury and the Board of Directors, Federal Financing Bank:

We have audited the statements of financial position of the Federal Financing Bank (the Bank) as of September 30, 2008 and 2007 and the related statements of operations and changes in net position and cash flows (hereinafter referred to as financial statements) for the years then ended, and have issued our report thereon dated November 10, 2008.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the Bank is responsible for establishing and maintaining effective internal control. In planning and performing our fiscal year 2008 audit, we considered the Bank's internal control over financial reporting by obtaining an understanding of the design effectiveness of the Bank's internal controls, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements. To achieve this purpose, we did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to express an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Bank's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Bank's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Bank's financial statements that is more than inconsequential will not be prevented or detected by the Bank's internal control. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Bank's internal control.

In our fiscal year 2008 audit, we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

We noted certain matters that we have reported to the management of the Bank in a separate letter dated November 10, 2008.

This report is intended solely for the information and use of the Bank's management, the U.S. Department of the Treasury's Office of Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 10, 2008

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report on Compliance and Other Matters

Inspector General, U.S. Department of the Treasury and the Board of Directors, Federal Financing Bank:

We have audited the statements of financial position of the Federal Financing Bank (the Bank) as of September 30, 2008 and 2007, and the related statements of operations and changes in net position and cash flows (hereinafter referred to as financial statements) for the years then ended, and have issued our report thereon dated November 10, 2008.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the Bank is responsible for complying with laws, regulations, and contracts applicable to the Bank. As part of obtaining reasonable assurance about whether the Bank's financial statements are free of material misstatement, we performed tests of the Bank's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts applicable to the Bank. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests of compliance described in the preceding paragraph of this report disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

This report is intended solely for the information and use of the Bank's management, the U.S. Department of the Treasury's Office of Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 10, 2008