



\$6,750,000,000

Federal National Mortgage Association

Zero Coupon Subordinated Capital Debentures Due 2019

The Capital Debentures do not pay interest periodically and will mature in the principal amount of \$6,750,000,000 at their stated maturity on October 9, 2019. The only scheduled payment to the holder of a Capital Debenture will be the principal amount due at maturity. The Capital Debentures are not redeemable prior to maturity. The Capital Debentures are subordinated and junior in right of payment to all obligations of the Corporation issued or to be issued under Section 304(b) of the Federal National Mortgage Association Charter Act. The Capital Debentures will be issued in registered form only in minimum denominations of \$5,000 (principal amount at stated maturity) and integral multiples of \$5,000 in excess thereof. For a more complete description of the terms of the Capital Debentures, see "Description of the Capital Debentures."

The Capital Debentures will be issued with substantial "original issue discount." Upon the sale of a Capital Debenture prior to maturity or upon its payment at maturity, U.S. withholding taxes may apply unless an exemption is available. An exemption is generally available to a non-U.S. holder. For a discussion of the United States tax consequences of ownership of Capital Debentures, see "United States Taxation."

Application will be made to list the Capital Debentures on the New York Stock Exchange.

THE CAPITAL DEBENTURES ARE NOT GUARANTEED BY THE UNITED STATES AND DO NOT CONSTITUTE A DEBT OR OBLIGATION OF THE UNITED STATES OR OF ANY AGENCY OR INSTRUMENTALITY THEREOF OTHER THAN THE CORPORATION. THE CAPITAL DEBENTURES ARE NOT REQUIRED TO BE REGISTERED UNDER THE SECURITIES ACT OF 1933. ACCORDINGLY, NO REGISTRATION STATEMENT HAS BEEN FILED WITH THE SECURITIES AND EXCHANGE COMMISSION.

The Capital Debentures are being offered from time to time in negotiated transactions or otherwise at varying prices to be determined at the time of sale. A substantial portion of the Capital Debentures is expected to be sold to purchasers outside the United States. See "Underwriting." Net proceeds to the Corporation will be \$206,415,000, before deducting expenses payable by the Corporation estimated to be \$190,000.

The Capital Debentures are offered subject to receipt and acceptance by the Underwriter, to prior sale and to the Underwriter's right to reject any order in whole or in part and to withdraw, cancel or modify the offer without notice. It is expected that delivery of Capital Debentures will be made at the office of Salomon Brothers Inc, One New York Plaza, New York, New York, or through the facilities of The Depository Trust Company, on or about October 9, 1984.

Salomon Brothers Inc
acting as Underwriter of the securities

Nomura Securities International, Inc.
assisting the Underwriter in the distribution of the securities

No person has been authorized to give any information or to make any representation not contained in this Offering Circular. If given or made, such information or representation must not be relied upon as having been authorized by the Corporation or the Underwriter. This Offering Circular does not constitute an offer of any securities other than the securities to which it relates or an offer to any person in any jurisdiction where such an offer would be unlawful. Neither delivery of this Offering Circular nor any sale made hereunder shall under any circumstances create an implication that information contained herein is correct as of any time subsequent to the date hereof.

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SUMMARY OF OFFERING

The information set forth below should be read in conjunction with, and is qualified in its entirety by, the detailed information and financial statements contained elsewhere in this Offering Circular.

Issuer	Federal National Mortgage Association (the "Corporation") is the largest investor in home mortgages in the United States. Created in 1938 to provide supplemental liquidity to the home mortgage market, the Corporation has been a federally chartered shareholder-owned corporation since 1968.
Issue	Zero Coupon Subordinated Capital Debentures Due 2019 with an aggregate principal amount at stated maturity of \$6,750,000,000.
Net Proceeds to the Corporation	\$206,415,000, before deducting expenses payable by the Corporation.
Purpose of Issue	Proceeds from the sale of the Capital Debentures will be added to the working capital of the Corporation and will be used for general corporate purposes.
Maturity Date	October 9, 2019.
Interest	The Capital Debentures do not pay interest periodically. The only scheduled payment to the holder of a Capital Debenture will be the principal amount due at maturity.
General	The Capital Debentures are issued under Section 304(e) of the Federal National Mortgage Association Charter Act. The Capital Debentures are not guaranteed by the United States and do not constitute a debt or obligation of the United States or any agency or instrumentality thereof other than the Corporation.
Subordination	The Capital Debentures, together with all other capital debentures which have been issued by the Corporation under Section 304(e) of the Federal National Mortgage Association Charter Act, are subordinated and junior in right of payment to all obligations of the Corporation issued or to be issued under Section 304(b) of the Corporation's Charter Act.
Redemption	The Capital Debentures are not subject to redemption prior to maturity.
Fiscal Agency Agreement ...	The Capital Debentures will be issued under a Fiscal Agency Agreement to be dated as of October 9, 1984, between the Corporation and Bankers Trust Company, as Fiscal Agent. The Corporation has initially appointed the Fiscal Agent's principal corporate trust office in New York City as its domestic paying agent and its principal corporate offices in Tokyo and London as paying agents outside the United States.
Form of Capital Debentures	The Capital Debentures will be issued in registered form only, in minimum denominations of \$5,000 and integral multiples of \$5,000 in excess thereof. All denominations of Capital Debentures are expressed in terms of principal amount at stated maturity.
Listing	Application will be made to list the Capital Debentures on the New York Stock Exchange.
United States Taxation	The Capital Debentures will be issued with substantial "original issue discount." This will require U.S. holders to include amounts in income before the receipt of cash attributable to such income. In the case of a qualifying non-U.S. holder, payments in respect of a Capital Debenture will not be subject to Federal income or withholding tax. Upon the sale of a Capital Debenture prior to maturity or upon its payment at maturity, U.S. "backup" withholding of 20 percent of the proceeds may apply unless an exemption is available. For a discussion of these provisions, as well as information as to the income tax effect of original issue discount on U.S. persons, see "United States Taxation."

PURPOSE OF ISSUE

The net proceeds from the sale of the Zero Coupon Subordinated Capital Debentures Due 2019 offered hereby (the "Capital Debentures"), which will be approximately \$206,415,000 before deduction of expenses, will be added to the working capital of the Federal National Mortgage Association (the "Corporation") and will be used for general corporate purposes. The Corporation anticipates that additional financing through all types of securities will be required from time to time. The amount and nature of such financing is dependent upon a number of factors, including the volume of commitments issued and mortgages purchased, as well as general market conditions. The sale of the Capital Debentures will increase the amount of additional senior borrowings permitted by Section 304(b) of the Charter Act. See "Corporate Indebtedness."

FEDERAL NATIONAL MORTGAGE ASSOCIATION

The Corporation is a federally chartered and privately owned corporation organized and existing under the Federal National Mortgage Association Charter Act (12 U.S.C. § 1716 *et seq.*) (the "Charter Act"). It is the largest investor in home mortgages in the United States, with a net portfolio of \$80.2 billion of mortgage loans as of June 30, 1984. The Corporation was originally established in 1938 as a United States government agency to provide supplemental liquidity to the mortgage market and was transformed into a stockholder-owned and privately managed corporation by legislation enacted in 1968.

The Corporation provides funds to the mortgage market primarily by purchasing home mortgage loans from local lenders, thereby replenishing their funds for additional lending. The Corporation acquires funds to purchase home mortgage loans from many capital market investors that may not ordinarily invest in mortgages, thereby expanding the total amount of funds available for housing. Operating nationwide, the Corporation helps to redistribute mortgage funds from capital-surplus to capital-short areas.

The Corporation was profitable in the first six months of 1984 and in 1983, after experiencing losses in 1982 and 1981. The primary cause of the losses in 1982 and 1981 was the excess of the cost of outstanding debt over the yield on the mortgage portfolio (or "negative spread"). In the first quarter of 1984 and in 1983 the negative spread was substantially narrower than the negative spread in 1982 and 1981 and its impact on results of operations was more than offset by income from other sources. During the second quarter of 1984, interest rates rose, increasing the negative spread. The Corporation currently anticipates a net loss from operations for the third quarter of 1984 and, if interest rates remain at current levels or increase further, the Corporation could experience unprofitable operating results for 1984 as a whole. See "Selected Financial Data," "Management's Discussion and Analysis of Financial Results" and "Mortgage Portfolio Spread."

Although the Secretary of the Treasury of the United States has discretionary authority to lend the Corporation up to \$2.25 billion outstanding at any time, neither the United States nor any agency thereof is obligated to finance the Corporation's operations or to assist the Corporation in any other manner.

The principal office of the Corporation is located at 3900 Wisconsin Avenue, N.W., Washington, D.C. 20016, and there are five regional offices located in Atlanta, Georgia; Chicago, Illinois; Dallas, Texas; Los Angeles, California; and Philadelphia, Pennsylvania. The Corporation also has a fiscal office at 100 Wall Street, New York, New York 10005.

Copies of the Corporation's most recent annual and quarterly reports and proxy statement are available without charge from John Meehan, Senior Vice President—Finance and Treasurer, Federal National Mortgage Association, 100 Wall Street, New York, New York 10005 (telephone: 212-425-9002) or Paul Paquin, Director of Investor Relations, Federal National Mortgage Association, 3900 Wisconsin Avenue, N.W., Washington, D.C. 20016 (telephone: 202-537-7115).

CAPITALIZATION

The following table sets forth the capitalization of the Corporation as of June 30, 1984, and as adjusted for the issuance of the Capital Debentures offered hereby.

	<u>Average Maturity</u>	<u>Average Annual Cost</u>	<u>Outstanding</u>	<u>As Adjusted</u>
(Dollars in thousands)				
Bonds, notes and debentures (1)				
Due within one year				
Short-term notes, net of unamor- tized discount	4 mos.	10.77%	\$11,397,027	\$11,397,027
Master notes.....	4 mos.	10.39%	729,444	729,444
Investment notes (2)		8.85%	7,625	7,625
Debentures.....	6 mos.	11.66%	17,022,245	17,022,245
Mortgage-backed bonds.....	3 mos.	7.29%	23,230	23,230
Capital debentures.....	7 mos.	11.77%	500,000	500,000
Total due within one year.....			29,679,571	29,679,571
Due after one year				
Debentures.....	3 yrs.	5 mos. 11.52%	48,173,435	48,173,435
Exchangeable debentures.....	6 yrs.	8 mos. 12.66%	450,000	450,000
Mortgage-backed bonds.....	5 yrs.	4 mos. 8.28%	394,423	394,423
Capital debentures offered here- by, net of unamortized discount	35 yrs.	10.22%	—	206,415
Capital debentures, net of un- amortized discount.....	9 yrs.	9.98%	1,145,922	1,145,922
Convertible capital debentures	12 yrs.	3 mos. 4.43%	27,465	27,465
Total due after one year			50,191,245	50,397,660
Total bonds, notes and debentures			\$79,870,816	\$80,077,231
Total stockholders' equity.....			\$ 1,287,732	\$ 1,287,732

(1) All of the outstanding bonds, notes and debentures were issued under Section 304(b) of the Charter Act except the capital debentures and convertible capital debentures which were issued under Section 304(e) and the mortgage-backed bonds which were issued under Section 304(d). See "Corporate Indebtedness" for a description of certain limitations applicable to debt issued by the Corporation.

(2) Investment notes have fixed interest rates. The outstanding balance associated with each note will fluctuate over the life of the note agreement. The average term of the outstanding investment note agreements is 24 years.

SELECTED FINANCIAL DATA

The following selected financial data for the years 1979 through 1983 (which data are not covered by the report of independent certified public accountants) have been summarized or derived from the audited financial statements. The financial data as of June 30, 1983 and 1984 and for the six-month periods then ended are unaudited and include, in the opinion of management, all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation. The results of operations for the six months ended June 30, 1984 are not necessarily indicative of the results expected for the entire year. These data should be read in conjunction with the audited financial statements and notes to financial statements which are presented elsewhere herein.

Condensed Statements of Operations (Dollars in millions, except per share amounts)

	Year Ended December 31,					Six Months Ended June 30,	
	1979	1980	1981(1)	1982	1983	1983	1984
Interest margin	\$ 322	\$ 21	\$ (463)	\$ (506)	\$ (62)	\$ (41)	\$ (17)
Commitment, guaranty and other fees	60	68	125	301	238	121	103
Gain (loss) on sales of mortgages	(2)	—	—	44	91	49	12
Other expenses	(81)	(63)	(22)	(96)	(129)	(60)	(67)
Income (loss) before Federal income taxes and extraordinary item	299	26	(360)	(257)	138	69	31
Provision for Federal income taxes	137	12	(170)	(123)	63	32	14
Income (loss) before extraordinary item	162	14	(190)	(134)	75	37	17
Extraordinary item: gain on early retirement of debt(2)	—	—	—	29	—	—	—
Net income (loss)	<u>\$ 162</u>	<u>\$ 14</u>	<u>\$ (190)</u>	<u>\$ (105)</u>	<u>\$ 75</u>	<u>\$ 37</u>	<u>\$ 17</u>
Earnings (loss) per share:							
Before extraordinary item:							
Primary	\$ 2.81	\$.24	\$(3.22)	\$(2.20)	\$ 1.15	\$.57	\$.26
Fully diluted	2.68	.23	(3.22)	(2.20)	1.13	.56	.26
Net:							
Primary	2.81	.24	(3.22)	(1.72)	1.15	.57	.26
Fully diluted	2.68	.23	(3.22)	(1.72)	1.13	.56	.26
Cash dividends per share	1.28	1.12	.40	.16	.16	.08	.08

Condensed Balance Sheets (Dollars in millions)

	At December 31,					At June 30,	
	1979	1980	1981	1982	1983	1983	1984
Assets							
Mortgage portfolio, net	\$49,655	\$55,742	\$59,846	\$69,714	\$75,665	\$72,231	\$80,220
Other assets	1,424	2,426	2,052	3,753	3,253	3,350	4,207
Total assets	<u>\$51,079</u>	<u>\$58,168</u>	<u>\$61,898</u>	<u>\$73,467</u>	<u>\$78,918</u>	<u>\$75,581</u>	<u>\$84,427</u>
Liabilities							
Bonds, notes and debentures:							
Due within one year	\$13,087	\$15,542	\$17,365	\$25,781	\$26,860	\$22,567	\$29,680
Due after one year	35,116	39,338	41,186	43,833	47,734	48,736	50,191
Other liabilities	1,375	1,831	2,104	2,650	3,048	3,038	3,268
Total liabilities	49,578	56,711	60,655	72,264	77,642	74,341	83,139
Stockholders' equity	1,501	1,457	1,243	1,203	1,276	1,240	1,288
Total liabilities and stockholders' equity	<u>\$51,079</u>	<u>\$58,168</u>	<u>\$61,898</u>	<u>\$73,467</u>	<u>\$78,918</u>	<u>\$75,581</u>	<u>\$84,427</u>

(1) Results for the year ended December 31, 1981 include a \$42.0 million reduction in the allowance for loan losses effected in the second quarter. There was also a decrease in the rate of providing for losses on conventional loans which resulted in a reduction in the loss provision of \$8.3 million during the last three quarters of 1981. Exclusive of these reductions, the 1981 loss would have been \$217.0 million or \$3.67 per share.

(2) In September 1982, the Corporation entered into a nontaxable transaction which resulted in the issuance of 6.3 million shares of its common stock in exchange for \$101 million of its long-term debentures, which were retired.

Condensed Statements of Changes in Financial Position
(Dollars in millions)

	Six Months Ended June 30,	
	1983	1984
Funds Provided		
Operations	\$ 24	\$ (2)
Proceeds from issuance of debentures and bonds	11,074	11,981
Increase (decrease) in short-term notes	(2,147)	586
Mortgage repayments, less discount amortized	3,297	2,958
Sales of mortgages, excluding gains and losses	2,538	942
Other items	204	20
Total funds provided	14,990	16,485
Funds Applied		
Debentures and bonds retired	7,251	7,301
Mortgage purchases including refinancings, less discount	8,470	8,518
Mortgage refinancings	(91)	(26)
Dividends paid	5	5
Total funds applied	15,635	15,798
Increase (decrease) in cash and marketable securities	(645)	687
Beginning balance, cash and marketable securities	2,453	1,720
Ending balance, cash and marketable securities	\$ 1,808	\$ 2,407

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL RESULTS

ANNUAL PERIODS

General

The Corporation was profitable in 1983 after experiencing losses in 1982 and 1981. The primary cause of the Corporation's losses in 1982 and 1981 was the combination of high interest rates and the mismatch in the maturities of the Corporation's asset and debt portfolios. When interest rates rose to unprecedented levels in 1980 and 1981, large amounts of maturing debt had to be refinanced at much higher costs. Turnover of assets was much slower. Although the Corporation purchased substantial volumes of high-yielding assets, the increase in yield on portfolio did not keep pace with the sharp increase in the cost of outstanding debt.

Starting in 1981, a new management team implemented a wide range of strategic and operating changes designed to mitigate this problem. The effect of these changes, aided by a moderation in interest rates, produced a sharp improvement in operating results in 1983.

Since the new management team started in 1981, the Corporation has:

- Purchased substantial volumes of adjustable rate and second mortgages, which allow the Corporation to more closely match the maturity of its assets with that of its borrowings;
- Restructured the channels for acquiring mortgages and greatly expanded the types of mortgage instruments purchased, resulting in purchases of high-yielding assets in record volumes;
- Increased the amount of revenue which is derived from sources other than interest income on the mortgage portfolio—commitment fees, mortgage-backed security guaranty fees and gains on sales of mortgages; and
- Issued liabilities with extended maturities when there were opportunities to do so at favorable rates, while relying on lower-cost, short-term borrowings in periods of higher interest rates.

This discussion and analysis describes how these management initiatives helped produce a profit in 1983.

Results of Operations

The Corporation's net income for 1983 was \$75.5 million, compared with a net loss of \$104.9 million in 1982 (\$133.8 million excluding an extraordinary gain). In 1981, the Corporation incurred a net loss of \$190.4 million (\$217.0 million excluding the effect of a reduction in the provision and allowance for conventional loan losses). The per share net income in 1983 was \$1.13, fully diluted, compared with the 1982 per share loss of \$1.72 (\$2.20 before extraordinary item) and the 1981 per share loss of \$3.22 (\$3.67 before reduction in the provision and allowance for conventional loan losses).

In 1983, cash dividends were \$.16 per share, compared with per share cash dividends of \$.16 and \$.40 in 1982 and 1981, respectively.

Overall portfolio performance is measured by the "spread" between the average net yield on the mortgage portfolio and the average cost of outstanding debt. In 1983, average portfolio yield was 10.67 percent and the average cost of outstanding debt was 11.12 percent, producing a negative spread of .45 percent. In 1982, average portfolio yield was 10.29 percent and the average cost of outstanding debt was 11.59 percent, resulting in a negative spread of 1.30 percent. In 1981, the average portfolio yield was 9.45 percent and the average cost of outstanding debt was 10.81 percent, producing a negative spread of 1.36 percent. This substantial improvement in spread was the major cause of the decrease in negative interest margin to \$61.5 million in 1983 from \$506.5 million in 1982 and \$462.9 million in 1981.

Average portfolio yield was 10.70 percent during December 1983, compared with 10.69 percent during December 1982 and 9.82 percent during December 1981. The moderation in interest rates experienced in 1983 resulted in a significant increase in prepayments of many of the high rate loans in the

Corporation's mortgage portfolio and also resulted in a downward adjustment of the net yield on its adjustable rate mortgages. These factors, combined with sales of mortgages in the form of mortgage-backed securities, reduced the favorable impact of 1983's record purchases and limited the improvement in yield to .01 percent during the year. The average cost of outstanding debt was 11.07 percent during December 1983, compared with 11.39 percent during December 1982 and 11.42 percent during December 1981.

Interest earned on marketable securities was \$221.7 million in 1983, compared with \$232.1 million in 1982 and \$140.0 million in 1981. This reflects the Corporation's decision to maintain an increased liquidity position in 1983 and 1982. The additional liquidity provides a temporary source of funding for mortgage purchases, which allows greater flexibility in structuring debt issues.

Other major sources of revenue are commitment fees, guaranty fees from mortgage-backed securities and gains on sales of mortgages. Commitment fees were \$151.2 million in 1983, compared with \$263.9 million in 1982 and \$112.6 million in 1981. The decline in commitment fees in 1983 resulted primarily from a decrease of \$2.9 billion or 21 percent in the volume of negotiated commitments and a decline of 45 percent in the average fee rate on negotiated transactions from 1.05 percent in 1982 to .58 percent in 1983. These declines reflect the increased competition in the mortgage market in 1983, which resulted from the lower interest rate environment.

Guaranty fees from mortgage-backed securities increased to \$54.3 million in 1983 from \$16.1 million in 1982 (the first full year of the program) and \$.3 million in 1981. This significant upward trend reflects the Corporation's success in marketing these securities. Mortgage-backed securities outstanding totaled \$25.1 billion at December 31, 1983, compared with \$14.5 billion and \$.7 billion at December 31, 1982 and 1981, respectively. These fees are a stable source of revenue and help to insulate the Corporation's earnings from fluctuations in interest rates.

Gains on sales of mortgages more than doubled in 1983 compared to 1982, increasing from \$44.4 million in 1982 to \$90.7 million in 1983. Sales volume increased from \$3.0 billion in 1982 to \$4.5 billion in 1983.

The Mortgage Portfolio

In 1983, the Corporation issued \$18.6 billion in mortgage purchase commitments, compared with \$22.1 billion and \$9.5 billion in 1982 and 1981, respectively. Negotiated transactions comprised 58 percent of commitments issued in 1983, compared with 62 percent in 1982 and 16 percent in 1981. The Corporation further reduced its issuance of optional delivery commitments where the yield is fixed at the time of the commitment. In 1983, the Corporation eliminated all such optional delivery commitment programs (except for adjustable rate mortgages), including the Free Market System auctions which were the primary channel for acquisition of mortgages prior to 1982. Such optional delivery commitments result in mortgage deliveries primarily when interest rates increase, so that assets are generally purchased at yields below current market levels. When rates decline, lenders are free to sell the loans to other investors at a better price. Mandatory delivery commitments eliminate this risk, as lenders are required to deliver at the commitment yield whether this is above or below the current rate. They also allow the Corporation to plan its borrowings and risk management strategies more effectively. As of December 31, 1983, total commitments outstanding were \$5.5 billion, compared with \$7.6 billion and \$3.7 billion at December 31, 1982 and 1981, respectively.

The Corporation's purchase volume in 1983 was a record \$17.6 billion at an average net yield of 12.65 percent, compared with \$15.1 billion at 15.00 percent in 1982 and \$6.1 billion at 15.38 percent in 1981. The spread between the net yield on purchases and the cost of debt issued in 1983 was 2.58 percent, compared with 2.18 percent in 1982 and a negative .84 percent in 1981. Adjustable rate mortgages and second mortgages comprised 24 percent and 8 percent, respectively, of 1983's purchase volume. In 1982, adjustable rate mortgages and second mortgages were 21 percent and 10 percent of total purchases, respectively. Adjustable rate and second mortgages together comprised only 5 percent of purchases in 1981. On December 31, 1983, the net mortgage portfolio was \$75.7 billion, compared with \$69.7 billion and \$59.8 billion on December 31, 1982 and 1981, respectively.

Mortgage repayments increased substantially to \$6.2 billion in 1983 compared with \$2.1 billion in 1982 and \$1.9 billion in 1981. As noted above, the moderation in interest rates in 1983 resulted in an increase in prepayments of high rate loans.

Financing Activities

Since the Corporation's assets have considerably longer maturities than the debt financing them, the average cost of outstanding debt is more volatile than the average yield on portfolio and, as a result, earnings will continue to be sensitive to interest rate changes. In 1983, the Corporation sought to maintain a balance between reducing the average cost of outstanding debt by relying on lower cost shorter-term borrowings and lengthening the average maturity of outstanding debt by issuing longer-term debentures when rates were favorable. In addition, the Corporation took advantage of other financing opportunities in the market by reopening existing debentures, implementing a new master note program and continuing its residential financing security program. Beginning in 1982, the Corporation initiated a risk management program, which uses the interest rate futures and other financial markets to provide protection against increases in borrowing costs.

In 1983, the Corporation raised a total of \$40.0 billion of debt at an average cost of 10.07 percent, compared with \$55.0 billion at 12.82 percent in 1982 and \$40.4 billion at 16.22 percent in 1981. The cost of debt issued in 1983, in addition to being substantially below that of 1982 and 1981, was also more stable throughout the year. In 1983, the cost of debt issued ranged from a monthly high of 10.41 percent in August to a low of 9.46 percent in January. The monthly high and low in 1982 were 15.41 percent in February and 9.72 percent in December, respectively.

The average maturity of outstanding debt increased from two years, three months at December 31, 1982 to two years, five months at December 31, 1983. The Corporation issued approximately \$6.7 billion of debentures with maturities of five years or more in 1983, compared with \$4.3 billion in this maturity range in 1982. Debt issued in 1983 included a \$250 million 30-year debenture offering with a 10-year par call provision.

The capital markets continued to be receptive to the Corporation's debt issues in 1983, as evidenced by narrower spreads between rates on the Corporation's securities and Treasury securities of similar maturities. Based on secondary market quotes of the comparative yields on the securities, the spread between the Corporation's six-month discount notes and six-month Treasury bills on a bond equivalent basis averaged .17 percent during 1983. This spread averaged .70 percent in 1982 and 1.09 percent in 1981. Measured similarly, the spread between the Corporation's five-year debentures and Treasury securities with a five-year maturity averaged .29 percent during 1983, compared with .64 percent in 1982 and .82 percent in 1981.

Mortgage-Backed Securities

In 1983, the Corporation issued \$13.3 billion of guaranteed mortgage-backed securities ("MBS"), compared with \$14.0 billion in 1982. The primary channel for issuance of MBS is "swap" transactions whereby participating lenders exchange pools of mortgages directly for securities. The Corporation also pools mortgages from its portfolio and issues securities for cash through public offerings and private placements. MBS issues from portfolio, which are treated as sales of assets, totaled \$4.4 billion in 1983 and \$3.0 billion in 1982. These portfolio sales increase market liquidity and also have produced substantial gains.

MBS guaranty fees grow in direct relation to the volume of MBS outstanding. The Corporation plans to continue being active in this market, which will provide it with a substantial stream of guaranty fee income that is not as interest rate sensitive as investing in mortgages for its own portfolio.

INTERIM PERIOD

Six Months Ended June 30, 1984

Net income for the six months ended June 30, 1984 was \$17.0 million or \$.26 per share, compared with \$38.5 million or \$.57 per share for the six months ended December 31, 1983 and \$37.0 million or \$.56 per share for the six months ended June 30, 1983. The reduction in net income was due largely to the declines in gain on sales of mortgages and commitment fees.

Mortgage purchases were \$9.2 billion during the first half of 1984, compared with \$8.6 billion and \$9.0 billion in the second half and first half of 1983, respectively. For the six-month period ended June 30, 1984, adjustable rate mortgages comprised 38 percent of all purchases, compared with 24 percent of all purchases in 1983. The net yield on mortgage purchases during the first half of 1984 was 12.37 percent, compared with 12.64 percent and 12.65 percent for purchases during the second half of 1983 and the first half of 1983, respectively. The net yield on the mortgage portfolio was 10.81 percent at June 30, 1984, compared with 10.70 percent at December 31, 1983 and 10.66 percent at June 30, 1983.

Debt issued during the first half of 1984 had an average cost of 11.30 percent, compared with 10.25 percent and 9.84 percent for debt issued during the second half of 1983 and the first half of 1983, respectively. The cost of total debt outstanding increased to 11.41 percent at June 30, 1984, from 11.12 percent at December 31, 1983 and 11.10 percent at June 30, 1983.

During the first half of 1984, the average portfolio yield was 10.75 percent and the average cost of outstanding debt was 11.18 percent, producing a negative spread of .43 percent. In the second half of 1983, the average portfolio yield was 10.64 percent and the average cost of outstanding debt was 11.09 percent, resulting in a negative spread of .45 percent. In the first half of 1983, the average portfolio yield of 10.69 percent and the average cost of outstanding debt of 11.14 percent produced a negative spread of .45 percent. Interest margin, which includes income from short-term investments as well as net yield on the mortgage portfolio, was a negative \$17.2 million in the first half of 1984, compared with a negative \$20.1 million in the last half of 1983 and a negative \$41.4 million in the first half of 1983.

The Corporation issued \$10.1 billion in mortgage commitments in the first half of 1984, compared with \$9.6 billion in the second half of 1983 and \$9.0 billion in the first half of 1983. Commitment fees totaled \$52.0 million for the six months ended June 30, 1984. For the six-month periods ended December 31, 1983 and June 30, 1983, commitment fees were \$68.6 million and \$82.7 million, respectively. Commitment fees declined primarily because of a change in product mix and competition in the mortgage marketplace.

Mortgage-backed security guaranty fees were \$35.2 million for the first six months of 1984, compared with \$30.7 million for the six-month period ended December 31, 1983 and \$23.6 million for the six-month period ended June 30, 1983. The increase in fees is due to an increase in the amount of securities outstanding from \$20.9 billion at June 30, 1983 to \$25.1 billion at December 31, 1983, and to \$29.3 billion at June 30, 1984.

The gain on sales of mortgages was \$11.7 million for the first half of 1984 compared with \$41.9 million and \$48.8 million in the second half and first half of 1983, respectively. The decline largely results from a decrease in sales activity from \$2.6 billion in the first half of 1983 and \$1.9 billion in the second half of 1983 to \$1.0 billion in the first half of 1984.

Continuing high interest rates have generally resulted in the Corporation refinancing debt in 1984 at a cost which is above the rates borne by the refinanced debt. As a result of higher cost debt, the Corporation's negative spread widened to .69 percent during August 1984. The Corporation currently anticipates a net loss from operations for the third quarter of 1984 and, if interest rates remain at current levels or increase further, the Corporation could experience unprofitable results of operations for 1984 as a whole. For information concerning historical spreads and the amount and cost of long-term debt maturing during the remainder of 1984 and the first half of 1985, see "Mortgage Portfolio Spread."

The Corporation charged off \$42.8 million in foreclosure losses against the allowance for loan losses on conventional mortgages in the first half of 1984, a significant increase over such charge-offs in prior periods. The Corporation is making a supplemental addition of \$35 million to its allowance for loan losses on conventional mortgages. This supplemental addition will increase the anticipated net loss from operations for the third quarter of 1984. In addition, because of the increase in the number and size of foreclosure losses, the Corporation will be increasing the rates at which it adds to the allowance for losses at the time that conventional loans are purchased. The Corporation will also discontinue the accrual of interest on all conventional loans that are 90 days or more delinquent. These two changes will have an adverse effect on the Corporation's results of operations in the fourth quarter of 1984. See "Mortgage Portfolio—Conventional Mortgage (Whole Loan) Portfolio Loss and Delinquency Experience."

MORTGAGE PORTFOLIO SPREAD

The Corporation's portfolio profitability depends on the difference, or "spread," between the return it receives on its mortgage portfolio and the cost of money it borrows to finance that portfolio. The following table sets forth the spread on the portfolio during the periods indicated.

For the Month	Net Portfolio at Month-End (In millions)	Average Yield(1)	Average Cost of Outstanding Indebtedness(1)			Spread
			Short-term Notes	Bonds and Debentures	Aggregate	
December 1979	\$49,655	8.74%	11.90%	8.29%	8.72%	.02%
December 1980	55,742	9.20	13.93	9.29	9.87	(.67)
December 1981	59,846	9.82	16.10	10.63	11.42	(1.60)
December 1982	69,714	10.69	10.85	11.55	11.39	(.70)
1983						
September	72,789	10.62	9.63	11.37	11.11	(.49)
October	73,256	10.62	9.64	11.41	11.15	(.53)
November	74,291	10.65	9.59	11.34	11.07	(.42)
December	75,665	10.70	9.64	11.35	11.07	(.37)
1984						
January	76,438	10.71	9.67	11.36	11.08	(.37)
February	76,700	10.74	9.72	11.35	11.08	(.34)
March	78,224	10.75	9.86	11.36	11.11	(.36)
April	79,083	10.75	10.07	11.45	11.21	(.46)
May	79,736	10.76	10.36	11.46	11.27	(.51)
June	80,220	10.79	10.67	11.49	11.33	(.54)
July	80,726	10.83	11.03	11.58	11.46	(.63)
August	81,022	10.85	11.30	11.63	11.54	(.69)

(1) Average yield on portfolio is calculated for the month shown and converted to an annual interest rate using, as the numerator, the interest income plus the amortized discount less servicing fees and, as the denominator, the average outstanding unpaid principal balance of the mortgage portfolio less unamortized discount. Similarly, the average cost of bonds and debentures and aggregate indebtedness is calculated using actual expense and the average outstanding applicable indebtedness during the month. The average cost of short-term indebtedness is the average original issue cost computed on a 365-day basis.

Approximately \$16.0 billion principal amount at maturity of bonds and debentures (original term of one year or longer) matured or will mature during the twelve months following June 30, 1984, as shown below.

<u>Maturity Date</u>	<u>Principal Amount at Maturity</u> (In millions)	<u>Weighted Average Cost</u>	<u>Maturity Date</u>	<u>Principal Amount at Maturity</u> (In millions)	<u>Weighted Average Cost</u>
1984			1985		
July 10	\$1,428	9.04%	January 10	\$1,050	9.95%
August 7	534	10.90	February 11	1,250	14.85
August 10	1,000	11.15	March 11	1,050	11.17
September 10	1,000	9.26	April 10	500	13.81
October 10	1,000	13.36	May 10	1,600	12.87
November 12	1,075	17.08	June 19	1,400	9.62
December 10	1,650	12.05	Other Dates	1,156	11.36
Other Dates	353	9.90			

An improvement in the spread and a return to a positive spread will depend upon the Corporation's ability to increase the yield on its mortgage portfolio and to refinance maturing borrowings at lower rates.

HISTORY AND BUSINESS

The Corporation was incorporated on February 10, 1938 pursuant to Title III of the National Housing Act. The Corporation was then a wholly owned government corporation that borrowed operating funds almost entirely from the United States Treasury. Its business primarily consisted of the purchase and resale of mortgages insured by the Federal Housing Administration ("FHA") and, since 1948, mortgages guaranteed by the Veterans Administration ("VA"), for the purpose of establishing and maintaining a secondary market for such mortgages. Title III was revised on August 2, 1954 and called the Federal National Mortgage Association Charter Act. Under the new Charter Act, the Corporation became a mixed-ownership corporate instrumentality of the United States. In connection with its secondary market operations, the Corporation issued non-voting common stock to the institutions from which it purchased mortgages.

From 1950 to 1965, the Corporation was a constituent agency of the Housing and Home Finance Agency and from November 9, 1965 to September 1, 1968 the Corporation operated in the Department of Housing and Urban Development ("HUD"). The Charter Act, as in effect prior to September 1, 1968, empowered the Corporation to (1) conduct secondary market operations in FHA-insured and VA-guaranteed home mortgages consisting of purchases and sales of such mortgages ("Secondary Market Operations"), (2) perform special assistance functions in the purchase of mortgages as authorized by the President of the United States or by the Congress to assist in financing home mortgages in instances where established home financing facilities were inadequate ("Special Assistance Functions") and (3) manage and liquidate certain mortgages ("Management and Liquidating Functions").

Pursuant to amendments to the Charter Act enacted in the Housing and Urban Development Act of 1968 (the "1968 Act"), the Corporation was, as of September 1, 1968, partitioned into two separate and distinct corporations. One, the Government National Mortgage Association ("GNMA"), is a wholly owned corporate instrumentality of the United States within the Department of HUD. GNMA retained all of the assets and liabilities acquired and incurred under the Special Assistance Functions and Management and Liquidating Functions carried on by the predecessor corporation prior to the effective date of the 1968 Act.

The second, Federal National Mortgage Association, now constituted as a federally chartered corporation, retained the assets and liabilities related to the Secondary Market Operations prior to the effective date of the 1968 Act. The 1968 Act changed each share of outstanding non-voting common stock of the Corporation, par value \$100 per share, into one share of voting common stock without par value and authorized the Corporation to issue its common stock to the public. The 1968 Act also provided for a transitional period for the Corporation's stockholders to assume control of the Corporation, and all preferred stock theretofore held by the Secretary of the Treasury was retired as of September 30, 1968. Accordingly, the entire equity interest in the Corporation became, and is now, publicly owned.

Government Supervision

Although the 1968 Act eliminated all Federal ownership interest in the Corporation, it did not terminate the significant government regulation of the Corporation. Under the Charter Act, approval of the Secretaries of the Treasury and HUD is required for the Corporation's issuance of its obligations; however, the Secretary of HUD has delegated the authority to approve the issuance of the Corporation's debt instruments to the Secretary of the Treasury. The Secretary of the Treasury has approved the issuance of the Capital Debentures.

Obligations of the Corporation issued under Section 304(b) of the Charter Act are subject to limitations imposed by the Charter Act and regulations adopted by HUD. See "Corporate Indebtedness."

In addition to specific enumerated powers, including those described above, the Secretary of HUD is granted general regulatory power over the Corporation under Section 309(h) of the Charter Act with

authority to promulgate rules and regulations to carry out the purposes of the Charter Act. The Secretary also may require, pursuant to said Section 309(h), that a reasonable portion of the Corporation's mortgage purchases be related to the national goal of providing adequate housing for low- and moderate-income families, but with a reasonable economic return to the Corporation.

The Charter Act also gives the Secretary of HUD the authority to audit and examine the books and financial transactions of the Corporation, but this authority has never been exercised.

Although ten members of the Corporation's fifteen-member Board of Directors are elected by the holders of the Corporation's common stock, the remaining five members are required to be appointed by the President of the United States. One such appointed director is required to be from each of the home building, mortgage lending, and real estate industries. Any member of the Board of Directors, including a member elected by stockholders, may be removed by the President of the United States for good cause.

In addition to placing the Corporation under significant Federal supervision, the Charter Act also grants to the Corporation certain privileges and immunities that it would not otherwise enjoy. For instance, securities issued by the Corporation are deemed to be "exempt securities" under laws administered by the Securities and Exchange Commission to the same extent as securities that are obligations of, or guaranteed as to principal and interest by, the United States. Accordingly, no registration statement or other document with respect to the Capital Debentures has been filed with the Securities and Exchange Commission.

As described in "Corporate Indebtedness," the Corporation has the authority to borrow up to \$2.25 billion from the Secretary of the Treasury. Any such borrowing would be within the Secretary's discretion and the Corporation has not used this facility since its transition from government control.

The Corporation is exempt from all taxation by any state or by any county, municipality or local taxing authority except for real property taxes. The Corporation is not exempt from payment of Federal corporate income taxes. Also, the Corporation may conduct its business without regard to any qualification or similar statute in any state of the United States, including the District of Columbia, the Commonwealth of Puerto Rico and the territories and possessions of the United States.

The Federal Reserve Banks are authorized to act as depositaries, custodians and fiscal agents for the Corporation, for its own account or as fiduciary.

MORTGAGE PORTFOLIO

General

The principal activity of the Corporation consists of the purchase of mortgages, primarily on residential properties, meeting certain eligibility requirements established by statute and by the Corporation. Substantially all of such purchases are made by the Corporation pursuant to forward purchase commitments issued by the Corporation. Under such commitments, the Corporation agrees in advance to purchase a specified dollar amount of loans at an agreed price. See "Commitments."

Prior to 1972, all mortgages purchased were insured or guaranteed by the Federal government, but since February 1972, under authority granted by the Emergency Home Finance Act of 1970, the Corporation has also purchased mortgages which are not federally insured or guaranteed (so-called "conventional mortgages"). See "Mortgage Purchase Activity."

Commitments

The Corporation's mortgage loan purchases are based on its issuance of commitments by which the Corporation agrees in advance to purchase a specified dollar amount of loans. Lenders often pay fees, typically from one-quarter of one percent to two percent of the amount of the commitment, for these commitments depending on market conditions, the type of mortgage loan and the length and characteristics of the commitment. However, a portion of the Corporation's commitments are issued for no fee.

The Corporation purchases most of its mortgages pursuant to mandatory delivery commitments. Under such commitments, lenders are obligated to sell mortgages to the Corporation at the commitment yield.

The Corporation also issues standby commitments. Under these commitments, the Corporation commits to purchase a designated amount of mortgages. A yield on the mortgages is not established at the time the standby commitment is issued. To deliver the mortgages, the lender must convert the standby commitment to a mandatory delivery commitment. In such event, the lender generally pays an additional fee to the Corporation. The yield on the mortgages is established at the time of conversion.

In early 1984, the Corporation conducted a test program involving guaranteed rate convertible commitments. Under this program, the Corporation has committed to purchase adjustable rate and fixed-rate mortgages at interest rates established during the offering period between January 23, 1984 and February 17, 1984. Mortgages can be delivered at the option of the lender against the commitment until October 17, 1984. To exercise the option, the lender must convert all or part of the optional delivery commitment to a mandatory delivery commitment according to a specified fee schedule. The Corporation has hedged commitments under the test program using a variety of financial instruments.

The following table sets forth the Corporation's mortgage commitment activity in connection with both the portfolio and mortgage-backed securities.

Mortgage Commitments
(Dollars in millions)

<u>Commitments Issued</u>	Year Ended December 31,					Six Months Ended June 30, 1984
	1979	1980	1981	1982	1983	1984
Portfolio:						
Home: Government insured or guaranteed	\$ 5,698	\$5,570	\$2,971	\$ 923	\$ 141	\$ 20
Conventional: Fixed-rate	4,441	2,511	4,927	13,405	10,562	5,177
Adjustable rate	—	—	1,360	6,024	6,573	4,111
Second trust	—	—	213	1,745	1,325	317
Total home mortgages	10,139	8,081	9,471	22,097	18,601	9,625
Project: Fixed-rate	40	2	—	9	6	415
Adjustable rate	—	—	—	—	—	78
Total project mortgages	40	2	—	9	6	493
Total portfolio	\$10,179	\$8,083	\$9,471	\$22,106	\$18,607	\$10,118
Mortgage-backed securities	\$ —	\$ —	\$3,259	\$15,517	\$15,722	\$32,879(1)
At December 31,						
<u>Commitments Outstanding</u>	1979	1980	1981	1982	1983	At June 30, 1984
Portfolio:						
Home: Government insured or guaranteed	\$ 3,243	\$2,246	\$ 920	\$ 44	\$ 8	\$ 2
Conventional: Fixed-rate	3,111	1,008	1,468	4,016	1,554	1,461
Adjustable rate	—	—	1,279	3,331	3,828	4,016
Second trust	—	—	31	206	66	111
Total home mortgages	6,354	3,254	3,698	7,597	5,456	5,590
Project: Fixed-rate	55	24	19	9	4	48
Adjustable rate	—	—	—	—	—	2
Total project mortgages	55	24	19	9	4	50
Total portfolio	\$ 6,409	\$3,278	\$3,717	\$7,606	\$ 5,460	\$ 5,640
Mortgage-backed securities	\$ —	\$ —	\$2,555	\$ 2,331	\$ 1,627	\$28,756(1)

(1) The substantial increase in the commitment volume for mortgage-backed securities in the first six months of 1984 resulted from a marketing effort which included the elimination of commitment fees for a limited period on optional delivery mortgage-backed securities commitments. Because these optional delivery commitments were issued without charging any commitment fee, the Corporation expects that the delivery rate on these commitments will be lower than normal.

Mortgage Purchase Activity

As described above, the Corporation currently purchases conventional mortgages as well as mortgages that are insured by the FHA or guaranteed by the VA. Substantially all loans currently in the Corporation's portfolio are secured by first liens, but the Corporation also purchases second lien whole loans and participations in such loans. With the exception of \$5.6 billion of project loans held by the Corporation at June 30, 1984, all of the mortgage loans purchased by the Corporation and held in its portfolio are secured by residential one- to four-family properties. Since FHA-insured and VA-guaranteed loans, because of their government backing, involve minimal risk from a credit standpoint, the Corporation's basic eligibility criterion for their purchase is simply the FHA insurance or the VA guaranty. Because conventional loans have no Federal government backing, the Corporation has established certain eligibility criteria for their purchase in an effort to reduce the risk of loss from mortgagor defaults. Because adjustable rate mortgages have the potential for a higher risk of default than fixed-rate mortgages, the Corporation has established special criteria for such mortgages. For information on the Corporation's loss and delinquency experience on conventional mortgage loans, see "Conventional Mortgage (Whole Loan) Portfolio Loss and Delinquency Experience."

Generally, the Corporation requires that the unpaid principal amount of each conventional mortgage purchased by it (i) not be greater than 80 percent of the appraised value of the mortgaged property, or (ii) if it is greater than 80 percent, that the excess over 75 percent be insured by an acceptable mortgage insurance company for so long as the principal balance of the loan is greater than 80 percent of such original appraised value (or of the appraised value as determined by a subsequent appraisal). Mortgage insurance is not required on mortgages with loan-to-value ratios greater than 80 percent (but not greater than 90 percent) if the mortgage seller retains a participation in the mortgage of not less than 10 percent or, in certain instances, agrees to repurchase the loan in the event of default.

Sellers of mortgages to the Corporation generally retain, subject to the Corporation's supervision, the responsibility for servicing the loans sold to the Corporation. Servicers are compensated through the retention of a specified portion of each interest payment on a serviced mortgage loan. Servicing includes the collection and remittance of principal and interest payments, administration of escrow accounts, collection of insurance claims and, if necessary, processing of foreclosures.

Conventional mortgage loans may not be purchased by the Corporation if their principal balance at the time of purchase exceeds \$114,000, except for loans secured by properties in Alaska and Hawaii or by two- to four-family dwelling units, where higher maximums apply. Loans eligible for insurance by the FHA are subject to statutory maximum amount limitations, and the Corporation imposes maximum amount limitations on loans guaranteed by the VA. Maximum principal balances applicable to the Corporation's conventional mortgage purchases are increased annually if there have been increases in the average cost of certain homes.

Generally, conventional mortgages purchased by the Corporation must conform to underwriting guidelines established by the Corporation. These guidelines are designed to assess the creditworthiness of the mortgagor as well as to assure that the value of the mortgaged home is sufficient to secure the mortgage loan. These guidelines are changed from time to time by the Corporation, and the Corporation may deviate from them as to particular loans.

At June 30, 1984, the large majority of the Corporation's mortgage portfolio consisted of fixed-rate mortgage loans. Substantially all such loans provide for level monthly installments of principal and interest, such installments consisting primarily of interest during the early and middle years, with the major portion of the original principal balance being payable during the years immediately preceding maturity. The great majority of such loans had original maturities of not less than 25 years (generally 30 years for single-family loans and 40 years for project loans). At June 30, 1984, the weighted average dollar life (based on the underlying amortization schedules and assuming no prepayments) of the mortgage loans in the Corporation's mortgage portfolio was approximately 25 years, and the weighted average yield (net of servicing and based on the Corporation's prepayment assumptions derived from historical prepayment experience) was 10.81 percent.

The following table sets forth the composition of the Corporation's mortgage loan portfolio, purchase activity, principal repayments and mortgage sales, the weighted average yield (net of servicing) on the mortgage portfolio and the average net yield on mortgages purchased.

Mortgage Portfolio
(Dollars in millions)

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>Six Months Ended June 30, 1984</u>
Unpaid Principal Balances at End of Period						
Home: Government insured or guaranteed....	\$29,381.7	\$33,416.7	\$34,550.7	\$33,742.3	\$30,999.9	\$29,615.9
Conventional: Fixed-rate.....	16,106.0	18,358.0	21,153.2	27,789.6	32,533.3	35,537.3
Adjustable rate.....	—	—	106.8	3,331.9	7,126.3	10,127.6
Second trust.....	—	—	175.3	1,635.5	2,385.4	2,352.4
Project: Fixed-rate.....	5,609.1	5,551.9	5,425.9	5,314.4	5,211.3	5,537.5
Adjustable rate	—	—	—	—	—	72.7
Total unpaid balance	<u>\$51,096.8</u>	<u>\$57,326.6</u>	<u>\$61,411.9</u>	<u>\$71,813.7</u>	<u>\$78,256.2</u>	<u>\$83,243.4</u>
Average yield net of servicing	8.75%	9.24%	9.85%	10.73%	10.70%	10.81%
Purchases During Period						
Home: Government insured or guaranteed....	\$ 5,387.8	\$ 5,272.5	\$ 2,284.0	\$ 901.1	\$ 186.1	\$ 91.3
Conventional: Fixed-rate.....	5,410.2	2,801.8	3,544.3	9,442.9	11,702.4	4,946.1
Adjustable rate.....	—	—	106.8	3,210.0	4,246.3	3,442.3
Second trust.....	—	—	175.9	1,552.3	1,407.9	270.1
Project: Fixed-rate.....	9.2	26.8	1.9	9.5	14.3	362.6
Adjustable rate	—	—	—	—	—	72.7
Total mortgages purchased.....	<u>\$10,807.2</u>	<u>\$ 8,101.1</u>	<u>\$ 6,112.9(1)</u>	<u>\$15,115.8(1)</u>	<u>\$17,557.0(1)</u>	<u>\$ 9,185.1(1)</u>
Average net yield on mortgages purchased....	10.11%	12.27%	15.38%	15.00%	12.65%	12.37%
Repayments During Period						
Home: Government insured or guaranteed....	\$ 2,060.7	\$ 1,343.3	\$ 1,252.1	\$ 1,263.6	\$ 2,045.5	\$ 946.5
Conventional: Fixed-rate.....	827.9	549.2	740.5	909.6	3,474.0	1,491.9
Adjustable rate.....	—	—	—	28.9	451.9	493.7
Second trust.....	—	—	.6	92.1	658.0	303.1
Project: Fixed-rate.....	115.3	84.0	127.1	121.0	117.4	36.4
Total mortgage repayments	<u>\$ 3,003.9</u>	<u>\$ 1,976.5</u>	<u>\$ 2,120.3(1)</u>	<u>\$ 2,415.2(1)</u>	<u>\$ 6,746.8(1)</u>	<u>\$ 3,271.6(1)</u>
Sales During Period						
Home: Government insured or guaranteed....	\$ —	\$ —	\$ —	\$ 518.2	\$ 907.2	\$ 528.8
Conventional: Fixed-rate.....	.7	.6	8.6	1,896.9	3,560.3	450.2
Adjustable rate.....	—	—	—	—	—	—
Second trust.....	—	—	—	—	—	—
Project: Fixed-rate.....	21.1	—	.8	—	—	—
Total sales.....	<u>\$ 21.8</u>	<u>\$.6</u>	<u>\$ 9.4</u>	<u>\$ 2,415.1</u>	<u>\$ 4,467.5</u>	<u>\$ 979.0</u>

(1) Includes \$630 million, \$617 million, \$126 million and \$26 million principal amount of mortgage loans which were refinanced under the Corporation's resale/refinance policy in 1981, 1982, 1983 and the first six months of 1984, respectively.

As shown by the above table, the level of principal repayments as a percentage of the Corporation's mortgage portfolio in 1983 and the first six months of 1984 reflects a substantial increase from the unusually low levels of 1980-1982. Since all of the loans in the Corporation's portfolio are prepayable by the borrower (in some cases with a small penalty), the moderation in interest rates experienced since 1982 resulted in a significant increase in prepayments of the high rate loans in the Corporation's mortgage portfolio. This moderation in rates also affected the Corporation's yield on its adjustable rate mortgages.

The low level of principal prepayments experienced in 1980-1982 contributed to the Corporation's losses in 1981 and 1982. As a result, the Corporation kept lower yielding mortgages on its books, which reduced significantly the increase in yield on its mortgage portfolio that, under more normal conditions, the Corporation would have expected to realize. In addition, the Corporation was forced to rely more heavily on high cost borrowings to finance new mortgage purchases and to refund maturing indebtedness.

The Corporation believes that the significant reduction in principal paydowns during 1980-1982 was due primarily to the high interest rate environment. The high cost of new financing resulted in both a decline in the number of home sales and a major portion of home sales being financed through so-called "creative" financing wherein the existing mortgage was assumed by the purchaser of the home (and generally coupled with second mortgage or purchase money financing) or "wrapped" by another loan from another lender. The Corporation currently enforces "due-on-sale" clauses in conventional fixed-rate mortgages purchased by the Corporation pursuant to commitments issued on and after November 10, 1980 and in conventional mortgages covering properties whose sale has been facilitated by "wraparound" or second mortgages made by institutional lenders. However, since approximately 60 percent of the Corporation's portfolio loans (including all FHA and VA loans) do not contain any such clause and a number of states substantially prohibit the enforcement of such clauses in mortgages originated or assumed during certain periods prior to October 15, 1982, the Corporation has been unable to prevent assumptions on a major portion of its portfolio.

Conventional Mortgage (Whole Loan) Portfolio Loss and Delinquency Experience

The portfolio of conventional mortgages that the Corporation purchased on a whole loan basis (as distinguished from participation interests) consists predominantly of loans made to owner-occupants and secured by first liens on residential real property. The loss and delinquency experience on this conventional whole loan portfolio is summarized in the following tables. These tables exclude whole loans purchased in summary format by the Corporation for which such statistics are not currently available.

Conventional Whole Loan Loss Experience (Dollars in millions)

	Year Ended December 31,					Six Months Ended June 30, 1984
	1979	1980	1981	1982	1983	
Principal balance at end of period	\$15,864.5	\$18,060.3	\$20,268.9	\$24,567.1	\$25,080.9	\$25,154.6
Net losses during period (1)	\$.8	\$.9	\$.8	\$ 1.6	\$ 38.4	\$ 42.8
Net loss ratio(2)	0.0050%	0.0050%	0.0039%	0.0065%	0.1531%	0.3403%
Number of loans at end of period	395,903	435,355	472,414	539,465	538,470	539,147
Number of foreclosures during period	219	368	606	1,270	2,963	2,458
Percent foreclosed(2)	0.0553%	0.0845%	0.1283%	0.2354%	0.5503%	0.9118%

(1) For 1979 through 1982, net losses were determined upon disposition of foreclosed properties by subtracting from the proceeds realized the sum of the book value of the foreclosed asset and related foreclosure costs, expenses, interest accrued but uncollected to the date of foreclosure and other carrying costs. Beginning in September 1983, estimated losses on acquired properties are charged to the allowance for losses when properties are acquired rather than at disposition. Write-downs to market for properties on hand produced a one-time charge to the allowance for losses of \$20.1 million in September 1983. Also charged to the allowance in September 1983 was \$6.2 million related to below market financing on sales of acquired properties in all prior periods. The items had no effect on reported net income in 1983 because losses had been provided for previously.

(2) The ratios are based on principal balance or number of loans at the end of the period. For the six months ended June 30, 1984 the ratios have been annualized.

Loan losses with respect to the remainder of the Corporation's total conventional first mortgage loan portfolio of \$20.5 billion were not significant during this period. However, the Corporation anticipates higher loan losses on this portion of the portfolio during the last six months of 1984.

As indicated in the preceding table, the net loss ratio has increased to .153 percent in 1983 and .340 percent (annualized rate) for the six months ended June 30, 1984, from .004 percent in 1981 and .007 percent in 1982. The increase in the net losses charged off resulted both from an increase in the percent of mortgage loans foreclosed and from a higher average loss per foreclosure. As a result of the increased net losses, the Corporation's total allowance for conventional loan losses (including the allowance for losses on loans in summary format and participations) declined from \$112.6 million at December 31, 1983 to \$81.7 million at June 30, 1984. The Corporation is making a supplemental addition of \$35 million to its allowance for loan losses on conventional mortgages. Loan losses may continue during the remainder of 1984 at a level that could result in a further reduction in the Corporation's allowance for loan losses by year-end. See "Management's Discussion and Analysis of Financial Results—Interim Period."

Conventional Whole Loan Delinquency Experience
(Percent of Portfolio By Number of Loans)

<u>Period of Delinquency</u>	<u>At December 31,</u>					<u>At June 30, 1984</u>
	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	
One month.....	2.9%	2.7%	2.9%	3.3%	3.5%	3.0%
Two months.....	.5	.5	.5	.7	.8	.7
Three or more months.....	.2	.1	.2	.3	.5	.4
Total (1).....	<u>3.6%</u>	<u>3.3%</u>	<u>3.6%</u>	<u>4.3%</u>	<u>4.8%</u>	<u>4.1%</u>
In foreclosure or under special lender forbearance (2).....	<u>.4%</u>	<u>.8%</u>	<u>.8%</u>	<u>1.0%</u>	<u>1.4%</u>	<u>1.4%</u>

(1) Delinquency percentages exclude loans in foreclosure or under special lender forbearance.

(2) A substantial percentage of loans in foreclosure or under special lender forbearance are reinstated.

Mortgage Purchase Policies

Since 1981, the Corporation has instituted a number of policies designed to make the Corporation's mortgage portfolio more responsive to fluctuations in prevailing interest rates and to better match its borrowing costs. These policies have had a favorable short-term effect on the Corporation's operations and are expected to be of importance in the future in mitigating the risks associated with rising interest rates. They include:

- *Purchase of Adjustable Rate Mortgage Loans ("ARMs").* The Corporation has developed standard plans applicable to the purchase of conventional mortgage loans that contain provisions for the automatic adjustment, both up and down, of their interest rates in accordance with changes in a specified index. Generally, such adjustments are limited by caps on payment or interest rate on the mortgage. The Corporation also has entered into special negotiated purchases of ARMs that do not conform to its standard plans. As of June 30, 1984, the Corporation had purchased \$11.0 billion of ARMs, had outstanding commitments totaling \$4.0 billion, and expects that future purchases will be substantial. The Corporation believes that these ARM loans will enable it to reduce the risk that the interest cost on its debt will exceed the income realized on its mortgage portfolio.

- *Resale/Refinance Loans.* Since March 1981, to upgrade the yield on its portfolio, the Corporation has offered financing to persons purchasing or refinancing homes that secure the Corporation's existing portfolio loans. These new loans are offered at interest rates that result from combining the existing balance at its original rate with an additional amount at a market rate. The resulting rate tends to be less than prevailing market rates but significantly greater than that applicable to the refinanced loan. Refinanced loans facilitate the complete financing of the sale and discourage the assumption of the existing loan as part of a financing package. As of June 30, 1984, \$2.5 billion resale/refinance loans had been made by the Corporation and, of that amount, \$1.1 billion, or 44 percent, represented newly loaned money.

● *Second Mortgages.* Substantially all of the loans currently in the Corporation's portfolio are secured by first liens; however, the Corporation also purchases conventional loans secured by second mortgages and participations in such loans. Second mortgages generally bear higher interest rates than contemporaneous first mortgages of a comparable maturity, have shorter maturities, and are usually prepaid prior to maturity. At June 30, 1984, the Corporation had purchased \$3.4 billion of second mortgages and had commitments to purchase \$.1 billion.

● *Guaranteed Mortgage Pass-Through Certificates.* In November 1981, the Corporation began issuing guaranteed mortgage pass-through certificates evidencing beneficial interests in pools of conventional loans that are generally sold to the Corporation by lenders in exchange for certificates. The Corporation began issuing similar certificates representing beneficial interests in FHA/VA mortgages and similar certificates representing beneficial interests in growing equity mortgages in October and November 1982, respectively. The Corporation began issuing similar certificates representing beneficial interests in ARMs and graduated payment mortgages in July and August 1984, respectively.

As of June 30, 1984, \$33.4 billion of guaranteed mortgage pass-through certificates had been issued and \$29.3 billion were outstanding. The Corporation's lenders either hold the certificates or sell them to private investors. In addition, the Corporation pools mortgages from its own portfolio or purchases mortgages from lenders in exchange for cash, assembles the mortgages in a pool, and sells the related certificates pursuant to public offerings and private placements. These securities, which are modeled after the highly successful GNMA mortgage-backed security program (which applies only to U.S. government-backed mortgages), are playing a significant role in the Corporation's operations. The Corporation receives fees for its origination, servicing and guaranty of certificates, a portion of which is paid by the Corporation to institutions that directly service pooled loans on behalf of the Corporation. The Corporation expects that the guaranteed mortgage pass-through certificates will enable it to further its statutory purpose of increasing the liquidity of residential mortgages without requiring that the Corporation take the financing or "spread" risk on the pooled loans.

However, because the Corporation guarantees timely payment of loans in certificate pools, it absorbs the ultimate credit risk on all loans in these pools. This risk may be offset somewhat to the extent that sellers of pools of loans elect to remain at risk on the loans sold. If the loss rate on conventional loans in such pools should appreciably increase, the Corporation's losses could, to the extent not offset by recourse to sellers, become significant.

CORPORATE INDEBTEDNESS

The Corporation borrows in the capital markets more than any other privately owned corporation in the United States. Although the Corporation is privately owned and its obligations (other than its outstanding mortgage-backed bonds guaranteed by GNMA) are not backed by the United States or any agency or instrumentality thereof other than the Corporation, the Corporation's debt has traditionally been treated as "U.S. Agency" debt in the marketplace. The Corporation, as a result, has historically enjoyed ready access to funds in the private credit markets at rates that are slightly higher than the yields on U.S. Treasury obligations of comparable maturities.

The following table sets forth at June 30, 1984 the maturity profile of the Corporation's bonds and debentures that were originally issued with a maturity of one year or longer.

<u>Maturing Within</u>	<u>Principal Amount at Maturity</u>	<u>Weighted Average Cost</u>
	(In millions)	
One year	\$16,045	11.78%
One to two years	12,977	12.12
Two to three years	15,311	11.40
Three to four years	10,011	11.24
Four to five years	5,393	11.73
Over five years	6,519	10.44

At June 30, 1984, the Corporation had short-term and master notes outstanding aggregating \$12.5 billion at face amount. Such notes had a weighted average term to maturity of 110 days at such date and a weighted average cost of 10.76 percent.

The outstanding indebtedness of the Corporation consists of general unsecured obligations issued under Section 304(b) of the Charter Act, subordinated capital debentures (including convertible capital debentures) issued under Section 304(e) of the Charter Act, and mortgage-backed bonds issued under Section 304(d) of the Charter Act.

Section 304(b) provides that the aggregate amount of obligations outstanding under such subsection shall not exceed, at any one time, fifteen times the sum of the capital (including, for this purpose, capital debentures), capital surplus, general surplus, reserves and undistributed earnings of the Corporation unless a greater ratio is fixed by the Secretary of HUD. On December 22, 1982, the Secretary of HUD increased this ratio to 30:1. Regulations adopted by HUD provide that this increased ratio is, in the event of a reduction in the Corporation's capital, automatically increased to such ratio as shall be necessary to include all obligations outstanding pursuant to Section 304(b). Pursuant to Section 304(e) of the Charter Act, the Capital Debentures and other subordinated obligations of the Corporation are deemed to be "capital" of the Corporation for the purpose of determining the aggregate amount of obligations that may be outstanding under Section 304(b) under the test set forth above. The sale of the Capital Debentures will therefore increase the amount of additional borrowings permitted by Section 304(b). The aggregate amount of obligations that may be outstanding under Section 304(b) will be increased immediately by approximately \$6.2 billion upon the issue and sale of the Capital Debentures and will increase further over time as the discount at which the Capital Debentures are issued amortizes. At June 30, 1984, this debt to capital ratio was 25.5:1 (23.9:1 as adjusted for issuance of the Capital Debentures), as compared with a ratio of 24.9:1 at June 30, 1983.

Prior to October 15, 1982, Section 304(e) of the Charter Act provided that the total principal amount of subordinated obligations which may be outstanding at any one time shall not exceed two times the sum of (i) the capital of the Corporation represented by its outstanding common stock and (ii) its surplus and undistributed earnings at such time. Although this restriction was removed by Congress in 1982, the Corporation is obligated to holders of certain outstanding issues of subordinated capital debentures (not including the Capital Debentures) to maintain such ratio until such outstanding debentures mature or are redeemed. Regulations adopted by HUD also provide that, at the maturity or other event requiring the payment or redemption of any obligations issued under Section 304(e) of the Charter Act, the permitted ratio of Section 304(b) debt to capital is automatically increased as necessary to permit the issuance of obligations under Section 304(b) of the Charter Act in an amount sufficient to provide the proceeds required to pay the principal of and interest on the obligations outstanding under Section 304(e) and so required to be paid at such time.

Issuances of indebtedness pursuant to Section 304(b) are also subject to the condition that, at the time of any such issuance, the aggregate amount of indebtedness outstanding under such Section 304(b), after giving effect to the indebtedness being issued, is not greater than the Corporation's ownership, free from any liens or encumbrances, of cash, mortgages or other security holdings and obligations, participations or other investments. Unlike the debt to capital ratio limitation described above, this Section 304(b) limitation is statutory and may not be waived or varied by the Secretary of HUD. For purposes of each of the foregoing calculations, the Corporation accounts for debt obligations issued at a discount at their book value (face amount less unamortized discount).

Section 304(d) of the Charter Act, pursuant to which mortgage-backed bonds and guaranteed mortgage pass-through certificates are outstanding, contains no limitation on the amount of obligations that may be outstanding thereunder. Section 304(d) of the Charter Act provides, however, that the mortgages pledged or set aside must be sufficient at all times to make debt service payments on the securities. At June 30, 1984, the Corporation had \$417.7 million in mortgage-backed bonds outstanding, of which \$408.5 million were guaranteed by GNMA pursuant to Section 306(g) of the National Housing Act, and are thus backed by the full faith and credit of the United States.

Section 304(c) of the Charter Act authorizes the Secretary of the Treasury, as a public debt transaction, to purchase obligations of the Corporation up to a maximum of \$2.25 billion outstanding at any one time. The Corporation has not used such borrowing facility with the U.S. Treasury since its transition from government control. Although the Secretary of the Treasury is authorized to purchase the obligations of the Corporation, he is under no requirement to do so. Any such obligations purchased by the Secretary of the Treasury must be issued pursuant to Section 304(b) of the Charter Act and, accordingly, would be subject to the applicable limitations and restrictions described above.

The following table sets forth the Corporation's borrowing activity and outstanding borrowings (principal amount at maturity), the respective costs of borrowings and average maturities.

Debt (Dollars in millions)						
	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>Six Months Ended June 30, 1984</u>
Short-Term Notes, Master Notes and Investment Notes						
Issued during period:						
Amount	\$10,567	\$17,654	\$30,185	\$34,196	\$20,262	\$11,642
Cost.....	11.75%	14.29%	16.56%	12.31%	9.47%	10.71%
Average Maturity—Days	198	152	98	129	161	188
Outstanding at end of period:						
Amount	\$ 6,593	\$ 8,578	\$ 9,189	\$11,752	\$11,841	\$12,494
Cost.....	12.09%	14.68%	15.47%	10.48%	9.67%	10.76%
Average Maturity—Days	108	92	57	141	106	110
Bonds and Debentures						
Issued during period:						
Amount	\$10,056	\$11,500	\$10,221	\$20,785	\$19,756	\$11,991
Cost.....	9.71%	12.05%	15.26%	13.62%	10.66%	11.75%
Average Maturity—Months	57	48	43	36	53	42
Outstanding at end of period:						
Amount	\$41,831	\$46,604	\$49,560	\$58,300	\$63,066	\$67,756
Cost.....	8.33%	9.32%	10.71%	11.55%	11.38%	11.51%
Average Maturity—Months	45	41	36	32	34	33
Total Debt						
Issued during period:						
Amount	\$20,623	\$29,154	\$40,406	\$54,981	\$40,018	\$23,633
Cost.....	10.72%	13.37%	16.22%	12.82%	10.07%	11.30%
Average Maturity—Months	31	22	13	16	29	26
Outstanding at end of period:						
Amount	\$48,424	\$55,182	\$58,749	\$70,052	\$74,907	\$80,250
Cost.....	8.81%	10.11%	11.42%	11.38%	11.12%	11.41%
Average Maturity—Months	39	35	31	27	29	29

RECENT LEGISLATIVE DEVELOPMENTS

On September 11, 1984, the U.S. House of Representatives passed S. 2040, entitled "A bill to amend the Securities Exchange Act of 1934 with respect to the treatment of mortgage-backed securities, to increase the authority of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, and for other purposes." The bill would, among other things, amend the Corporation's Charter Act to: (i) require the Corporation to calculate, in the case of a participation interest purchased by the Corporation, the conventional mortgage limit with respect to the total original principal obligation of the mortgage; (ii) authorize the Corporation until October 1, 1987, to purchase, service, sell, lend on the security of, and otherwise deal in subordinate mortgages on 1-to 4-family residences in sizes up to one-half the applicable first lien limit and, until October 1, 1985, also to purchase and deal in subordinate mortgages on multifamily units; (iii) delete the applicability to conventional multifamily mortgages of the statutory loan-to-value ratio affecting purchases by the Corporation; (iv) increase the multifamily mortgage loan limit affecting purchases by the Corporation to 240 percent of the Section 207 FHA multifamily limits in HUD-designated high cost areas; (v) expand the Board of Directors of the Corporation from fifteen to eighteen members by the addition of three new stockholder-elected directors; (vi) require the HUD Secretary to report annually to the Congress on the Corporation's activities; (vii) require the HUD Secretary to respond to any statutory request for approval or other action by the Corporation within 45 days, subject to a possible 15-day extension; (viii) remove after September 30, 1985, the HUD Secretary's authority to approve issuances of new obligations by the Corporation, but retain such authority regarding all new issuances by the Corporation of stock and debt obligations convertible into stock.

The U.S. Senate passed similar legislation, entitled the "Secondary Mortgage Market Enhancement Act of 1983" (S. 2040), on November 17, 1983. That legislation, like the House bill, would, if enacted, remove certain impediments to trading and investing in mortgage-backed securities through the amendment of various securities laws and investment laws applicable to financial institutions, and amend the Corporation's Charter Act in ways generally similar to the House bill. Further action by the Senate to reconcile differences in that bill with the House-passed legislation is expected.

A bill (H.R. 3420) was introduced in the House of Representatives on June 27, 1983 that would raise the single-family conventional mortgage limits for both the Corporation and the Federal Home Loan Mortgage Corporation ("FHLMC") in HUD-designated high-cost areas. As of July 27, 1984 this bill was sponsored by 111 Representatives. An identical bill (S. 2130) was introduced in the Senate on November 17, 1983. This bill is sponsored by four Senators.

The ultimate effect of the above legislation on the Corporation's business and results of operations will depend upon the enactment and final provisions of this legislation.

The 1985 budget report of the President of the United States includes the following statement: "The Administration remains committed to the total privatization of two housing-related, Government-sponsored enterprises—the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. An interagency cabinet-level group will continue to pursue this goal. Because they are sponsored by the Federal government, these two enterprises receive special advantages in the securities markets that completely private institutions do not have." Similar statements were included in the 1983 and 1984 budget reports. Any alteration of the relationship of the Corporation to the Federal government would require legislation to be introduced in and passed by both Houses of Congress and signed by the President. No such legislation has been introduced to date. Alteration or elimination of the Corporation's relationship with the Federal government could require the Corporation to change the manner in which it currently conducts business and could have a material adverse effect on its results of operations. Except for the particular bills summarized above, the Corporation is unaware of any specific legislative proposals that would alter in any material way its current status.

MANAGEMENT

The senior officers of the Corporation, their ages as of September 1, 1984 and business experience are as follows:

David O. Maxwell, 54, has been Chairman of the Board of Directors and Chief Executive Officer since May 1981. He served briefly as the Corporation's President and Chief Operating Officer from February 1981 until his election to his present position. Prior to his employment with the Corporation, Mr. Maxwell was Chairman of the Board and Chief Executive Officer of Ticor Mortgage Insurance Company.

Robert J. Mylod, 44, has been President and Chief Operating Officer since January 1983. Prior to his employment with the Corporation, Mr. Mylod was President of Advance Mortgage Corporation.

Caryl S. Bernstein, 50, has been Executive Vice President since February 1982; Secretary since July 1981; and General Counsel since May 1981. Mrs. Bernstein was Senior Vice President from May 1981 until her election as Executive Vice President. Prior to her employment with the Corporation, Mrs. Bernstein held a number of positions with the Overseas Private Investment Corporation ("OPIC"), a U.S. government agency that encourages private investment in less developed countries and insures against certain risks involved in such overseas investments. Mrs. Bernstein's most recent title at OPIC was Vice President for Insurance.

Stuart A. McFarland, 37, became Executive Vice President and Chief Financial Officer on October 31, 1983. From November 1982 until October 31, 1983, Mr. McFarland was Executive Vice President and Chief Planning Officer. From May 1981 until November 1982, Mr. McFarland was the Corporation's Executive Vice President—Operations. Prior to his employment with the Corporation, Mr. McFarland held a number of positions with Ticor Mortgage Insurance Company, most recently that of President.

Michael A. Smilow, 46, became Executive Vice President—Operations on July 16, 1984. Prior to his employment with the Corporation, Mr. Smilow was with MGIC Investment Corporation—Capital Markets and Commercial Markets Groups since 1980, where he held the position of Senior Vice President. From 1978 to 1980, Mr. Smilow was Deputy Director, Office of State Agency and Bond Financed Programs, Department of Housing and Urban Development.

Richard R. Betchley, 35, has been Senior Vice President—Marketing and Regional Activities since February 1982. Prior to his employment with the Corporation, Mr. Betchley was the Manager of the Southern California Bond & Money Market Headquarters for Crocker National Bank. Mr. Betchley held a number of general management positions with Crocker National Bank, where he was employed from December 1975 until January 1982.

Douglas M. Bibby, 38, became Senior Vice President—Corporate Affairs on October 18, 1983. Prior to his employment with the Corporation, Mr. Bibby was Vice President of Russell Reynolds Associates, Inc., an executive recruiting firm. Mr. Bibby was previously employed by the J. Walter Thompson Company for twelve years, where his last position was as Senior Vice President.

Richard H. Daniel, 38, became Senior Vice President—Regional Activities on June 19, 1984. From April 1984 until June 19, 1984, Mr. Daniel was Vice President for Regional Activities. Mr. Daniel was the Corporation's Vice President for Marketing from March 1983 until April 1984. Prior to his employment with the Corporation, Mr. Daniel was employed by Wells Fargo & Company, where he was Vice President and Manager of the real estate division of the retail banking group.

Stephen Frank, 44, became Senior Vice President and Controller on October 18, 1983. From June 1981 until October 18, 1983, Mr. Frank was Vice President and Controller. Mr. Frank has been employed in the Corporation's Office of the Controller since 1970.

F. G. Gosling, 58, has been Senior Vice President—Administration since February 1982. From 1973 until assuming his present position, Mr. Gosling was the Corporation's Vice President for Administration.

John P. Harding, 39, became Senior Vice President—Planning and Financial Analysis on October 18, 1983. From November 1981 until October 18, 1983, Mr. Harding was Vice President for Corporate Planning. Mr. Harding has been in the Corporation's Office of Corporate Planning since June 1975.

J. Timothy Howard, 36, became Senior Vice President and Chief Economist on October 18, 1983. Mr. Howard has been the Corporation's Chief Economist since March 1982. Prior to his employment with the Corporation, Mr. Howard was Vice President and Senior Financial Economist for Wells Fargo Bank.

J. Donald Klink, 47, has been Senior Vice President—Mortgage-Backed Securities since October 18, 1983. From June 15, 1982 until October 18, 1983, Mr. Klink was Senior Vice President—Mortgage Securities and Negotiated Transactions. Mr. Klink was the Corporation's Vice President for Mortgage Marketing from August 1981 until February 1982, when he was elected Vice President for Mortgage Securities and Negotiated Transactions. Prior to his employment with the Corporation, Mr. Klink was employed by Coast Federal Savings and Loan Association for seven years, where he held the position of Senior Vice President in charge of mortgage banking.

Robert J. Mahn, 56, has been Senior Vice President—Mortgage Operations since February 1982. Mr. Mahn was the Corporation's Vice President and Controller from April 1969 until June 1981, when he was elected Vice President for Mortgage Operations.

John J. Meehan, 39, has been Senior Vice President—Finance and Treasurer since February 1982. Mr. Meehan was the Corporation's Vice President for Finance and Treasurer from May 1981 until his election to his present position. Prior to that, Mr. Meehan was Vice President and Fiscal Agent. Mr. Meehan has been with the Corporation since 1975.

Dale P. Riordan, 36, became Senior Vice President—Government Relations on October 18, 1983. Since 1981, Mr. Riordan has held various managerial positions with the Corporation, most recently that of Vice President for Government Relations. Prior to his employment with the Corporation, Mr. Riordan was Chief Economist of the National Savings and Loan League.

BOARD OF DIRECTORS

The age and background, as of September 1, 1984, of each of the members of the Board of Directors of the Corporation, and certain persons who served as members of the Board from the dates shown until their terms expired on May 17, 1984 (see footnote 2 to the table below), are as follows:

<u>Name and Age</u>	<u>Principal Occupation and Business Experience</u>	<u>First Became Director</u>	<u>Other Directorships(1)</u>
Eli Broad—51	Chairman of the Board and Chief Executive Officer of Kaufman and Broad, Inc., a housing and financial services corporation, 1976 to present; President and Chief Executive Officer, Sun Life Insurance Company of America, 1983 to present; Chairman of the Board, Sun Life Group of America, Inc., a life insurance-holding company, 1978 to present; Chairman of the Board of Sun Life Insurance Company of America, 1975 to 1979	1984	

<u>Name and Age</u>	<u>Principal Occupation and Business Experience</u>	<u>First Became Director</u>	<u>Other Directorships(1)</u>
Merrill Butler(2)—59	President, Chief Executive Officer and Chairman of the Board, The Butler Group, Inc., a home building company, January 1984 to present; President and Chairman of the Board, Butler Housing Corporation, a home building company, 1971-1983; Chairman of the Board, Bullard Homes Corporation, a home building company, 1976 to present; President and Chairman of the Board, BHC Housing, Inc., a home building corporate subsidiary of Butler Housing Corporation, 1972 to present; President, National Association of Homebuilders, 1980	1981	Commodore Corporation
James B. Coles(2)—42	President and Chairman of the Board, James B. Coles, Inc., a framing contractor, 1972 to present; The Coles Development Company, Inc., a home building company, 1979 to present; C&C SunWest Contractors, Inc., 1982 to present; Pacific SunWest Marketing, Inc., 1983 to present	1981	
Bert A. Getz(2)—47	President and Director, Globe Corporation, a banking, real estate and investment company, 1975 to present	1981	Arizona Bancwest Corporation
Joseph P. Hayden—54	Chairman of the Board and Chief Executive Officer, The Midland Company and its subsidiaries, financing and insuring of manufactured housing, December 1980 to present; President and Chief Executive Officer, 1961 to December 1980	1969	The Midland Company; First National Cincinnati Corporation
Carla A. Hills—50	Partner, Latham, Watkins & Hills, a law firm practicing in Washington, D.C., Illinois and California, 1978 to present; Secretary, U. S. Department of Housing & Urban Development, 1975 to 1977	1982	AMR Corporation; Corning Glass Works; International Business Machines Corporation; The Signal Companies, Inc.; Chevron Corporation

<u>Name and Age</u>	<u>Principal Occupation and Business Experience</u>	<u>First Became Director</u>	<u>Other Directorships(1)</u>
Dianne E. Ingels(2)—43	Partner, The York Companies, a real estate development, acquisition and marketing firm, January 1984 to present; Principal, Dianne Ingels and Associates, an independent real estate broker, investor and consultant, 1977 to present; President, Ingels Company, 1976 to 1977; Chairman, Colorado Springs Urban Renewal Commission, 1974 to 1976	1981	
John E. Krout—64	Chairman of the Board, Germantown Savings Bank, a mutual savings bank, 1977 to present; President, Germantown Savings Bank, 1971 to 1977	1970	Chicago Title & Trust Co.; Trustee; PNB Mortgage & Realty Investors
James E. Lyon(2)—56	Chairman of the Board, River Oaks Bancshares, Inc., a bank holding company, April 1, 1984 to present; Chairman of the Board, River Oaks Financial Corporation, 1962 to present; Chairman of the Board, Ruska Instrument Corporation, November 1961 to present	1981	
David O. Maxwell—54	Chairman of the Board of Directors and Chief Executive Officer of the Corporation, May 1981 to present; President and Chief Operating Officer of the Corporation, February to May 1981; Chairman of the Board and Chief Executive Officer, Ticor Mortgage Insurance Company, private mortgage insurance, February 1973 to February 1981	1981	
Robert J. Mylod—44	President and Chief Operating Officer of the Corporation, January 1983 to present; President of Advance Mortgage Corporation, 1975 to 1982; Executive Vice President, Advance Mortgage Corporation, 1973 to 1975	1983	
John M. O'Mara—57	Senior Vice President, Wertheim & Co., a securities business, July 1981 to present; Vice President, Merrill Lynch White Weld Capital Markets Group, a securities business, 1978 to July 1981; First Vice President, White Weld & Co., Inc., 1974 to 1978	1970	Baldwin & Lyons, Inc.

<u>Name and Age</u>	<u>Principal Occupation and Business Experience</u>	<u>First Became Director</u>	<u>Other Directorships(1)</u>
Samuel J. Simmons—57.....	President, National Caucus and Center on Black Aged, Inc., January 1982 to present; Housing and real estate consultant, May 1981 to present; President, National Center for Housing Management, a non-profit research and training organization, 1972 to May 1981	1978	
Richard C. Van Dusen—58	Executive Partner, Dickinson, Wright, Moon, Van Dusen & Freeman, a Detroit law firm, 1977 to present	1981	Pennwalt Corporation; Ticor Mortgage Insurance Company; Primark Corporation
Mallory Walker—45	President, Walker & Dunlop, Inc., a mortgage banking and real estate company, 1976 to present	1981	

(1) Companies with a class of securities registered pursuant to Section 12 of the Securities Exchange Act of 1934 or subject to the requirements of Section 15(d) of that Act or any company registered as an investment company under the Investment Company Act of 1940.

(2) These persons served as directors appointed by the President of the United States until their terms expired, pursuant to the Charter Act, on May 17, 1984. The Corporation has been informed that the President of the United States intends to appoint these individuals as directors of the Corporation for the term ending on the date of the 1985 annual meeting of stockholders.

DESCRIPTION OF THE CAPITAL DEBENTURES

General

The Capital Debentures are unsecured subordinated obligations of the Corporation issued pursuant to Section 304(e) of the Charter Act. The Capital Debentures are limited in aggregate principal amount at stated maturity to \$6,750,000,000. The Capital Debentures do not pay current interest but are being offered at a discount from their principal amount at stated maturity. See "United States Taxation." The Capital Debentures will mature on October 9, 2019. The Capital Debentures are not subject to redemption prior to maturity. The summaries of certain provisions of the Capital Debentures and the Fiscal Agency Agreement contained herein do not purport to be complete, and are qualified in their entirety by reference to all provisions of the Capital Debentures and of the Fiscal Agency Agreement, copies of which may be obtained without charge from the Corporation (by writing or telephoning the persons set forth under "Federal National Mortgage Association") or the Fiscal Agent.

In the event that the principal amount due on any Capital Debenture is not paid or duly provided for when due, whether at stated maturity or upon acceleration, the Corporation will pay interest on the unpaid amount from such due date until such amount is paid or duly provided for at the rate of 10.22 percent per annum, but only to the extent that the payment of such interest is legally enforceable.

The Capital Debentures will be issued under a Fiscal Agency Agreement to be dated as of October 9, 1984 (the "Fiscal Agency Agreement") between the Corporation and Bankers Trust Company. The Capital Debentures will be issued in registered form only in denominations of \$5,000 and integral multiples of \$5,000 in excess thereof. All denominations of the Capital Debentures are expressed in terms of principal amount at stated maturity.

Payment of principal and interest, if any, on the Capital Debentures will be made in such coin or currency of the United States as at the time of payment is legal tender therein for the payment of public and private debts and will be payable at the principal corporate trust office of the Fiscal Agent in New York City and at the paying agents of the Corporation. The Corporation will initially appoint as paying agents the principal offices of Bankers Trust Company in Tokyo, Japan and in London, England. The Corporation may vary or terminate the appointment of the paying agents, except that the Corporation will maintain at least one paying agent in Tokyo, Japan and London, England unless the Corporation determines that the cost of maintaining such non-U.S. paying agents is unreasonable or that maintaining such non-U.S. paying agents would, under applicable law, regulation or interpretations, adversely affect the Corporation. The Corporation may require a holder of a Capital Debenture, as a condition of payment of principal or interest, if any, on such Capital Debenture, to present a certificate in the form prescribed by the Corporation to enable it to determine its duties and liabilities with respect to any taxes or other charges which may be required to be deducted or withheld under United States law or any reporting or other requirements thereunder.

Capital Debentures may be presented to the Fiscal Agent for exchange or registration of transfer at its principal corporate trust office maintained for such purpose in New York City.

Any moneys paid by the Corporation to the Fiscal Agent for the payment of principal or interest, if any, on any Capital Debenture, and remaining unclaimed at the end of two years after such amounts shall have become due and payable, will be repaid to the Corporation upon its written request.

The debt obligations of the Corporation, including the Capital Debentures, together with any interest thereon, are not guaranteed by the United States and do not constitute a debt or obligation of the United States or of any agency or instrumentality thereof other than the Corporation.

An Event of Default will be defined in the Capital Debentures as (i) default in the payment of principal at stated maturity of any Capital Debenture as and when the same shall become due and payable at stated maturity or (ii) failure on the part of the Corporation duly to observe or perform in any material respect any other covenant, condition or agreement of the Corporation in the Capital Debentures for a period of sixty days. If an Event of Default shall have occurred and be continuing then the Corporation

shall publish promptly in a newspaper of general circulation in the Borough of Manhattan, City and State of New York, notice of the occurrence of such Event of Default. Irrespective of the giving of such notice, unless the principal of all of the Capital Debentures has already become due and payable, the holders of not less than 25 percent in aggregate principal amount at stated maturity of the Capital Debentures then outstanding, by notice in writing to the Corporation, may declare the principal of all of the Capital Debentures to be due and payable immediately. In the event of any such declaration the amount of principal due and payable shall be limited to the sum of (i) 3.058 percent of the principal amount at stated maturity of the Capital Debentures plus (ii) the accrued amortization of the original issue discount from the date of issue to the date of declaration determined on the basis of monthly compounding and in accordance with generally accepted financial practices.

The Fiscal Agency Agreement and the terms and conditions of the Capital Debentures may be amended by the Corporation and the Fiscal Agent, without the consent of the holder of any Capital Debenture, for the purposes of adding to the covenants of the Corporation for the benefit of the holders of Capital Debentures, or surrendering any right or power conferred upon the Corporation, or curing any ambiguity, or curing, correcting or supplementing any defective provision contained therein, or in any manner which the Corporation and the Fiscal Agent may determine and which does not adversely affect the interests of the holders of the Capital Debentures in any material respect.

Modifications and amendments to the Fiscal Agency Agreement or to the terms and conditions of the Capital Debentures may also be made, either with the written consent of the holders of at least a majority in aggregate principal amount at stated maturity of the Capital Debentures at the time outstanding, or by the adoption of a resolution at a meeting of holders of the Capital Debentures by at least 66⅔ percent in aggregate principal amount at stated maturity of the Capital Debentures represented at such meeting. However, no such modification or amendment to the Fiscal Agency Agreement or to the terms and conditions of any Capital Debenture may, without the consent of the holder of such Capital Debenture so affected, change the stated maturity of any such Capital Debenture; reduce the principal amount payable at stated maturity or upon acceleration of such Capital Debenture; change the currency of payment of principal of, or interest, if any, on such Capital Debenture; or reduce the percentage of the principal amount at stated maturity of Capital Debentures outstanding necessary to modify or amend the Fiscal Agency Agreement or the terms and conditions of the Capital Debentures. The quorum at any meeting called to adopt a resolution will be persons holding or representing a majority in aggregate principal amount at stated maturity of the Capital Debentures at the time outstanding.

Any instrument given by or on behalf of any holder of a Capital Debenture in connection with any consent to any such modification or amendment will be conclusive and binding on all subsequent holders of such Capital Debenture or any Capital Debenture issued directly or indirectly in exchange or substitution therefor. Any modification or amendment of the Fiscal Agency Agreement or to the terms and conditions of the Capital Debentures will be conclusive and binding on all holders of Capital Debentures, whether or not they have given such consent or were present at any meeting, and on all holders of Capital Debentures, whether or not notation of such modification or amendment is made upon the Capital Debentures.

Subordination

In the event and during the continuation of any default in the payment of principal of or premium, if any, or interest on any obligation of the Corporation issued or to be issued and outstanding pursuant to Section 304(b) of the Charter Act beyond any applicable period of grace, then, unless and until such default shall have been cured or waived or shall have ceased to exist, no payment of principal or interest, if any, on the Capital Debentures may be made. All statements herein relating to the payment of principal

of and interest on the Capital Debentures are qualified in their entirety by reference to such subordination. On June 30, 1984, the aggregate amount of such obligations (face amount net of unamortized discount) senior in right of payment to the Capital Debentures was \$77.8 billion.

Under the Charter Act and regulations adopted by HUD currently in effect, the amount of obligations that may be issued under Section 304(b) are subject to the limitations on Section 304(b) indebtedness discussed under "Corporate Indebtedness." The amount of obligations that may be issued under Section 304(b) is subject to increase or decrease depending on the ratio established by the Secretary of HUD and the future earnings of the Corporation, and may be increased through the sale of common or preferred stock or subordinated capital debentures by the Corporation. The amount of obligations that may be issued under Section 304(b) is also subject to increase or decrease depending on the amount of cash, mortgages and other assets of the Corporation. See "Corporate Indebtedness."

Regarding the Fiscal Agent

Bankers Trust Company has its principal corporate trust office at Four Albany Street, New York, York, N.Y. 10006. Bankers Trust Company is a participant in the Corporation's bank line of credit, under which no borrowings are currently outstanding, is a member of the selling group for certain of the Corporation's debt securities, and has other banking and contractual relationships with the Corporation.

UNITED STATES TAXATION

Set forth below is a discussion of certain Federal tax consequences to holders of the Capital Debentures, which is based upon present Federal tax law and reflects the impact of the recently enacted Deficit Reduction Act of 1984. The discussion does not purport to deal with all aspects of Federal taxation that may be relevant to particular investors. Prospective investors are advised to consult their own tax advisors regarding the Federal tax consequences to them of holding and disposing of Capital Debentures, as well as any tax consequences arising under the laws of any state or other taxing jurisdiction.

Original Issue Discount. For Federal income tax purposes, each Capital Debenture will be considered to have "original issue discount" equal to the difference between its "issue price" and the amount payable upon the stated maturity of the Capital Debenture. The "issue price" of each Capital Debenture will be the initial offering price to the public at which a substantial amount of such Capital Debentures is sold, and the "issue date" will be the date on which a Capital Debenture is first issued to the public. As so determined, the issue price, issue date and original issue discount with respect to each Capital Debenture will be marked thereon.

U.S. Holders. Each original or subsequent "U.S. Holder" (as defined below) must include in ordinary gross income for Federal income tax purposes a portion of the original issue discount in each taxable year during which the Capital Debenture is held (subject to the adjustment described in the next paragraph for certain holders). The original issue discount allocated to each one-year period beginning on the issue date of the Capital Debenture and each anniversary thereof (an "accrual period") will equal the issue price of the Capital Debenture (increased by the amount of original issue discount allocated to all prior accrual periods) multiplied by the yield to maturity of the Capital Debenture determined on the basis of compounding at the close of each accrual period. The original issue discount so allocated to a particular accrual period will then be allocated ratably to each day in the accrual period, and the U.S. Holder (whether on the cash or accrual method of accounting for Federal income tax purposes) must include in its income for the taxable year the original issue discount so allocated to each day on which the Capital Debenture was held by such holder during that year.

A modification of the foregoing rule will generally apply to a U.S. Holder who acquires a Capital Debenture by "purchase" if the cost of such Capital Debenture to that holder exceeds the sum of (i) the issue price of the Capital Debenture and (ii) the total original issue discount allocable under the rules of the preceding paragraph to the entire period prior to the U.S. Holder's purchase of the Capital Debenture. In that case, the amount of original issue discount includible by such purchaser for any taxable year will

equal (i) the amount determined under the rules of the preceding paragraph, reduced by (ii) the portion of such excess purchase price allocable to the days on which the Capital Debenture is held by such purchaser during the taxable year. Such excess would be allocated so as to equal a constant percentage of the original issue discount allocable to each day (from the purchase date until the stated maturity date of the Capital Debenture) as described above. For this purpose, a "purchase" is any acquisition (including an acquisition from a decedent) of a Capital Debenture other than one in which the U.S. Holder's basis of the Capital Debenture is determined in whole or in part by reference to the basis of the Capital Debenture in the hands of the person from whom acquired (such as a gift).

The rules described above will require U.S. Holders to include amounts in income before the receipt of cash attributable to that income. Unless an exemption applies, as required under current Federal income tax law, holders of record and the U.S. Internal Revenue Service will be furnished with information concerning the amount of original issue discount that must be included in income by U.S. Holders for each year. While this information will be accurate as to original purchasers of the Capital Debentures who purchase their Capital Debentures at the issue price, other U.S. Holders will be required to determine for themselves whether they are eligible to report a reduced amount of discount income as described in the preceding paragraph.

If a U.S. Holder acquires a Capital Debenture that constitutes a "market discount bond," gain realized by such holder on the disposition of such Capital Debenture generally will be recognized as ordinary income to the extent of the market discount that accrued during the period such holder held the Capital Debenture (computed, at the holder's election, either on a straight line or constant interest rate basis). In addition, if a U.S. Holder incurs or continues indebtedness to purchase or carry a Capital Debenture that constitutes a "market discount bond," the interest on such indebtedness for any taxable year may not be fully deductible in such year to the extent it exceeds the original issue discount includible in the holder's income for that year with respect to such Capital Debenture. An exception to these market discount rules would apply if the U.S. Holder elects to include in income in each taxable year the portion of the market discount attributable to such year computed on a straight line basis (or if the holder irrevocably elects with respect to any Capital Debenture for all taxable years beginning with the year of purchase, a constant interest rate basis) with respect to all market discount bonds acquired on or after the first day of the taxable year to which the holder's election applies. A Capital Debenture will generally constitute a "market discount bond" if, and the amount of market discount will equal the amount by which, (i) the issue price, increased by the amount of original issue discount includible in gross income for all holders for periods prior to its acquisition by the U.S. Holder (without adjustment for any prior purchase premium) exceeds (ii) the U.S. Holder's basis in such Capital Debenture immediately after the acquisition thereof.

A U.S. Holder's basis for determining gain or loss on a sale or other disposition of a Capital Debenture generally will equal the U.S. Holder's cost therefor, increased by any original issue discount included in such holder's income and any market discount included in income under the election described in the preceding paragraph. Generally, any gain or loss recognized by a U.S. Holder on the sale, exchange, or payment at maturity of a Capital Debenture held for more than six months (or one year in the case of a Capital Debenture acquired after December 31, 1987) will be long term capital gain or loss, assuming the Capital Debenture is a capital asset in the hands of the U.S. Holder and subject to the rules described above for market discount bonds.

The foregoing provisions concerning original issue discount will not apply to a life insurance company to which Section 811(b) of the Internal Revenue Code of 1954, as amended (the "Code"), applies.

As used herein, "U.S. Holder" means a citizen or resident of the United States, a corporation created or organized in or under the laws of the United States or any political subdivision thereof, or an estate or trust whose income from sources without the United States is includible in gross income for Federal income tax purposes regardless of its connection with the conduct of a trade or business within the United States. The term also includes partnerships, nonresident alien individuals, foreign corporations, and foreign estates and trusts to the extent that their ownership of a Capital Debenture is effectively connected with the conduct of a trade or business within the United States, as well as certain former citizens and residents of the United States who, under certain circumstances, are taxed as if they were citizens or residents on income from U.S. sources.

Non-U.S. Holders. Under present Federal income and estate tax law (i) payments at the maturity of a Capital Debenture to any holder who is not a U.S. Holder and has no other connection to the United States subjecting it to U.S. taxation (a "Non-U.S. Holder") will not be subject to Federal withholding tax (except as provided in the discussion of backup withholding below) or Federal income tax if the beneficial owner has appropriately certified under penalties of perjury its non-U.S. status, provided that such holder does not own, either directly or through attribution, 10 percent or more of the total combined voting power of all classes of stock of the Corporation, (ii) any gain or income realized by a Non-U.S. Holder upon the sale of a Capital Debenture prior to maturity will not be subject to Federal withholding tax (except as provided in the discussion of backup withholding below) or Federal income tax, and (iii) a Capital Debenture held by an individual who at the time of death is not a citizen or resident of the United States will not be subject to Federal estate tax upon such individual's death, provided that at the date of death the individual does not own, either directly or through attribution, 10 percent or more of the total combined voting power of all classes of stock of the Corporation. The U.S. Treasury is empowered to publish a determination that a certification from any person or class of persons will not be sufficient to preclude the imposition of the withholding tax with respect to payments of interest (including original issue discount) on the Capital Debentures made at least one month after the publication of such determination.

Backup Withholding. A 20 percent "backup" withholding tax and information reporting requirements generally apply to certain payments at the maturity of a Capital Debenture, and payment of the proceeds of the sale of a Capital Debenture before maturity, to noncorporate U.S. Holders. However, backup withholding will not apply to those noncorporate U.S. Holders who provide certain identifying information in the manner required by law and regulations. Under current U.S. Treasury regulations, backup withholding will not apply to payments to a Non-U.S. Holder at the maturity of a Capital Debenture, or to payment by the United States office of a "broker" (as defined in such regulations) of the proceeds of the sale of a Capital Debenture before maturity, provided that the beneficial owner (i) provides appropriate certification (to the payor or any institution holding the Capital Debenture for the beneficial owner) under penalties of perjury of its non-U.S. status and lack of certain connections to the United States (and any institution holding the Capital Debenture for such beneficial owner provides certification under penalties of perjury that it has received from such beneficial owner such certification) or (ii) otherwise establishes an exemption. Information reporting will apply with respect to payments of interest (including original issue discount) at stated maturity to Non-U.S. Holders. However, backup withholding and information reporting will not apply to payment of the proceeds of the sale of a Capital Debenture before maturity if the foreign office of a foreign broker pays such proceeds to the seller thereof, regardless of whether the identity or status of the beneficial owner of the Capital Debenture has been certified or documented (provided that such broker derives less than 50 percent of its gross income for certain periods from the conduct of a trade or business in the United States and is not a "controlled foreign corporation" within the meaning of Section 957 of the Code). The payment by the foreign office of other brokers of the proceeds of the sale of a Capital Debenture will not be subject to backup withholding, but will be subject to information reporting unless the broker has documentary evidence in its records that the beneficial owner is not a U.S. person and certain other conditions are met, or the beneficial owner otherwise establishes an exemption.

The U.S. Treasury has announced that it is currently reviewing the foregoing backup withholding and information reporting rules, and the application of such rules to the Debentures may be changed prospectively by new regulations.

If a holder does not qualify for an exemption under the backup withholding rules, any backup withholding taxes would be allowed as a refund or a credit against such holder's Federal income tax, provided that the required information is furnished to the U.S. Internal Revenue Service.

UNDERWRITING

Subject to the terms and conditions set forth in the Underwriting Agreement, the Corporation has agreed to sell to Salomon Brothers Inc (the "Underwriter"), and the Underwriter has agreed to purchase, all the Capital Debentures at a purchase price equal to the amount shown as net proceeds to the Corporation on the cover page of this Offering Circular.

The distribution of the Capital Debentures by the Underwriter is being effected from time to time in negotiated transactions or otherwise at varying prices to be determined at the time of sale. The Underwriter will effect certain of such transactions by selling Capital Debentures to or through certain dealers, including Nomura Securities International, Inc., and such dealers will receive compensation in the form of underwriting discounts, concessions or commissions from the Underwriter and/or any purchasers of Capital Debentures for whom they may act as agent (which compensation may be in excess of customary commissions). The Underwriter may also receive compensation from purchasers of Capital Debentures for whom it may act as agent. A substantial portion of the Capital Debentures is expected to be sold to purchasers outside the United States.

In the Underwriting Agreement, the Underwriter has agreed, subject to the terms and conditions set forth therein, to purchase all the Capital Debentures if any Capital Debentures are purchased. The Underwriting Agreement provides that the Corporation will indemnify the Underwriter against certain liabilities, including liabilities under applicable securities laws, or contribute to payments the Underwriter may be required to make in respect thereof.

LEGAL OPINIONS

The validity of the Capital Debentures will be passed upon for the Corporation by Caryl S. Bernstein, Esq., Executive Vice President, General Counsel and Secretary of the Corporation, and for the Underwriter by Cravath, Swaine & Moore, New York, New York. Dewey, Ballantine, Bushby, Palmer & Wood, New York, New York and Washington, D.C., has acted as special tax counsel to the Corporation in connection with this offering.

ACCOUNTANTS

The financial statements of the Corporation included herein have been examined by Peat, Marwick, Mitchell & Co., independent certified public accountants, to the extent and for the periods indicated in their report thereon. Such financial statements have been included in reliance upon the report of Peat, Marwick, Mitchell & Co. and upon the authority of that firm as experts in accounting and auditing.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors and Stockholders
Federal National Mortgage Association:

We have examined the balance sheets of Federal National Mortgage Association as of December 31, 1983 and 1982, and the related statements of operations and changes in financial position for each of the years in the three-year period ended December 31, 1983. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned financial statements present fairly the financial position of Federal National Mortgage Association at December 31, 1983 and 1982 and the results of its operations and the changes in its financial position for each of the years in the three-year period ended December 31, 1983, in conformity with generally accepted accounting principles applied on a consistent basis.

PEAT, MARWICK, MITCHELL & CO.

Washington, D.C.
January 25, 1984

FEDERAL NATIONAL MORTGAGE ASSOCIATION

BALANCE SHEETS

Assets

	<u>December 31,</u>	
	<u>1983</u>	<u>1982</u>
	(Dollars in thousands)	
Mortgage portfolio, net	\$75,664,817	\$69,713,984
Cash	30,115	22,622
U.S. Government and Federal Agency securities at cost (market value of \$227.7 million in 1983 and \$631.7 million in 1982)	227,163	630,869
Federal funds	1,462,259	1,799,100
Accrued interest receivable	770,328	687,709
Federal income taxes refundable	152,601	330,505
Accounts receivable and other assets	202,660	61,861
Acquired property and foreclosure claims, less allowance for losses of \$10.0 million in 1983 (\$4.1 million in 1982)	347,035	168,961
Unamortized debenture issue costs	60,559	51,092
Total Assets	<u>\$78,917,537</u>	<u>\$73,466,703</u>

Liabilities and Stockholders' Equity

Liabilities:

Bonds, notes and debentures, net:

Due within one year	\$26,859,533	\$25,780,576
Due after one year	47,734,289	43,833,062
	74,593,822	69,613,638
Accrued interest payable	1,904,645	1,724,274
Mortgagors' escrow deposits, exclusive of approximately \$609.6 million held by servicers in 1983 (\$548.3 million in 1982)	271,440	266,231
Deferred Federal income taxes	568,200	488,194
Other liabilities	303,519	171,037
Total liabilities	<u>77,641,626</u>	<u>72,263,374</u>

Stockholders' Equity:

Common stock, \$6.25 stated value, no maximum author- ization—66,038,701 shares issued (65,650,117 shares in 1982)	412,742	410,313
Additional paid-in capital	310,913	305,750
Retained earnings	554,151	489,161
	1,277,806	1,205,224
Less Treasury stock, at cost—208,926 shares	1,895	1,895
Total stockholders' equity	<u>1,275,911</u>	<u>1,203,329</u>
Total Liabilities and Stockholders' Equity	<u>\$78,917,537</u>	<u>\$73,466,703</u>

See Notes to Financial Statements

FEDERAL NATIONAL MORTGAGE ASSOCIATION
STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	1983	1982	1981
	(Dollars in thousands, except per share amounts)		
Interest income:			
Mortgage portfolio	\$7,921,758	\$6,806,975	\$5,596,791
Less servicing fees	216,262	217,984	202,622
	7,705,496	6,588,991	5,394,169
Marketable securities	221,666	232,123	139,998
Total interest income	7,927,162	6,821,114	5,534,167
Interest on borrowings and related costs	7,988,663	7,327,570	5,997,097
Interest margin	(61,501)	(506,456)	(462,930)
Other income:			
Commitment fees	151,225	263,913	112,561
Gain on sales of mortgages	90,688	44,405	152
Guaranty fees	54,318	16,124	326
Other	32,622	20,617	11,883
Total other income	328,853	345,059	124,922
Other expenses:			
Administrative	80,760	60,067	49,462
Provision for losses	47,900	35,700	(27,600)
Total other expenses	128,660	95,767	21,862
Income (loss) before Federal income taxes and extraordinary item	138,692	(257,164)	(359,870)
Provision for Federal income taxes:			
Currently refundable	(15,200)	(200,900)	(271,300)
Deferred	78,400	77,500	101,800
	63,200	(123,400)	(169,500)
Income (loss) before extraordinary item	75,492	(133,764)	(190,370)
Extraordinary item: gain on early retirement of debt	—	28,899	—
Net income (loss)	\$ 75,492	\$ (104,865)	\$ (190,370)
Per share:			
Earnings (loss) before extraordinary item:			
Primary	\$ 1.15	\$ (2.20)	\$ (3.22)
Fully diluted	1.13	(2.20)	(3.22)
Net earnings (loss):			
Primary	1.15	(1.72)	(3.22)
Fully diluted	1.13	(1.72)	(3.22)
Cash dividends .....	.16	.16	.40
Average number of shares outstanding, in thousands	65,646	60,927	59,109

See Notes to Financial Statements

FEDERAL NATIONAL MORTGAGE ASSOCIATION
STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Year Ended December 31,		
	1983	1982	1981
	(Dollars in thousands)		
Funds Provided:			
Income (loss) before extraordinary item	\$ 75,492	\$ (133,764)	\$ (190,370)
Items not (providing) using funds:			
Interest capitalized on graduated payment mortgages, net	(99,841)	(116,342)	(102,111)
Provision for deferred Federal income taxes, net	78,400	77,500	101,800
Provision for losses	47,900	35,700	(27,600)
Funds provided by (applied to) operations before extraordinary item	101,951	(136,906)	(218,281)
Extraordinary gain—No funds effect	—	—	—
Proceeds from issuance of debentures and bonds ...	19,733,939	20,743,135	10,236,006
Increase in short-term notes	213,817	2,342,988	714,575
Mortgage repayments, less discount amortized	5,735,250	1,224,576	1,052,168
Foreclosure claims collected	425,440	289,063	230,684
Sales of mortgages, excluding gains and losses	4,370,300	2,071,297	9,340
Net increase in stockholders' equity resulting from debt exchange and debenture conversions	7,592	103,552	5
Increase in accrued interest payable/receivable, net	21,852	138,727	39,815
Other items, net	195,802	94,412	(86,185)
Total funds provided	30,805,943	26,870,844	11,978,127
Funds Applied:			
Debentures and bonds retired	14,991,082	12,044,363	7,265,815
Mortgage purchases including refinancings, less discount	16,663,040	14,047,268	5,903,936
Mortgage refinancings	(125,627)	(617,033)	(630,490)
Dividends paid	10,502	9,709	23,643
Total funds applied	31,538,997	25,484,307	12,562,904
Increase (decrease) in cash and marketable securities ...	(733,054)	1,386,537	(584,777)
Cash and marketable securities, beginning of year	2,452,591	1,066,054	1,650,831
Cash and marketable securities, end of year	\$ 1,719,537	\$ 2,452,591	\$ 1,066,054

See Notes to Financial Statements

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS

STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

The Corporation operates in the residential mortgage finance industry. Its accounting policies conform to generally accepted accounting principles. The following is a description of significant accounting policies and practices:

Mortgage Portfolio and Purchase Discount

Mortgages acquired for investment are carried at their unpaid principal balances less unamortized discount. Discount is recognized as income using an amortization method which produces a level yield over the estimated life of the related mortgages.

Allowance for Losses

In order to recognize losses which may be sustained due to defaults on conventional mortgages acquired for portfolio, the Corporation maintains an allowance for losses which is established by charges to income when the mortgages are purchased. In 1981, the Corporation reduced the allowance for losses by \$42.0 million and also reduced the rate at which provisions are made for estimated losses on conventional loans.

Risk Management

In 1982, the Corporation began taking positions in financial markets to hedge against fluctuations in interest rates which affect the cost of planned borrowings. Results of hedging activity are deferred and amortized to interest expense over the lives of the protected borrowings. There were no open positions at December 31, 1983.

Commitment Fees

Commitment fees are generally recognized as income upon the execution of the commitment contract. However, commitment fees that are considered to be an adjustment to the yield on the related mortgages purchased are deferred and recognized as income using an amortization method which produces a level yield over the estimated life of the related mortgages.

Income Taxes

Certain income and expense items are recognized in different periods for financial and income tax reporting purposes. Provisions for deferred income taxes are made for such timing differences. Investment tax credits are recognized as deductions from income tax expense in the year the related assets are purchased (flow-through method).

Earnings Per Share

Earnings per share are computed on the weighted average number of shares outstanding. Fully diluted earnings per share are computed on the assumption that all outstanding convertible capital debentures were converted at the beginning of the year, after increasing earnings for the related interest expense, net of Federal income taxes.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

MORTGAGE PORTFOLIO, NET

The mortgage portfolio balances consist of the following components:

	December 31,	
	1983	1982
	(Dollars in millions)	
Home mortgages:		
First mortgages:		
Government insured or guaranteed:		
Whole loans	\$30,970	\$33,730
Participations	30	12
	31,000	33,742
Conventional fixed-rate:		
Whole loans	28,108	24,662
Participations	4,425	3,127
	32,533	27,789
Conventional adjustable rate:		
Whole loans	6,120	2,775
Participations	1,006	557
	7,126	3,332
Second mortgages:		
Whole loans	989	382
Participations	1,397	1,254
	2,386	1,636
Project mortgages:		
Government insured	5,148	5,284
Conventional	63	31
	5,211	5,315
Total unpaid principal balance	78,256	71,814
Less:		
Unamortized discount	2,474	1,972
Allowance for losses	117	128
	\$75,665	\$69,714

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

BONDS, NOTES AND DEBENTURES, NET

Bonds, notes and debentures consist of the following:

	December 31,	
	1983	1982
	(Dollars in millions)	
Due within one year:		
Short-term notes—net of \$293 million discount in 1983 (\$418 million in 1982)	\$10,833	\$11,334
Master notes	715	—
Debentures	15,289	14,434
Mortgage-backed bonds	23	13
Total due within one year	26,860	25,781
Due after one year:		
Debentures	45,794	41,825
Mortgage-backed bonds	402	464
Capital debentures—net of \$20 million discount in 1983 (\$21 million in 1982)	1,510	1,509
Convertible capital debentures	28	35
Total due after one year	47,734	43,833
	\$74,594	\$69,614

Short-term notes are general obligations of the Corporation. These notes are issued in both discount and interest-bearing form. Maturities range up to 360 days, and denominations range from \$5,000 to \$1,000,000 with a minimum original purchase of \$50,000. Master notes are individually negotiated, variable principal amount short-term notes. These notes, which have varying maturities, carry a floating interest rate tied to 91-day U.S. Treasury bill rates which is adjusted weekly. Investors have the option of increasing or decreasing the principal amount outstanding on these notes on a daily basis, usually within a range of 80 to 120 percent of the original principal balance. The Corporation had short-term and master notes outstanding of \$11.8 billion (face amount) at December 31, 1983 and December 31, 1982. The largest face amount of notes outstanding at any month-end was \$11.8 billion in 1983; in 1982, \$11.9 billion. The average cost to the Corporation of notes outstanding at December 31, 1983 and 1982 was 9.7 percent and 10.5 percent, respectively. These rates represent the effective average cost computed on a 365-day basis, including commission and the effect of related hedging activity. The average remaining terms were approximately 106 and 141 days at December 31, 1983 and 1982, respectively. The average aggregate face amount of notes outstanding during 1983 was \$10.1 billion at an average cost of 9.67 percent; during 1982, it was \$9.0 billion at an average cost of 13.27 percent.

The Corporation has a \$322 million line of credit with a group of commercial banks. Interest on any borrowings is calculated at the prime rate used by Continental Bank. The credit agreement is terminable by either party on the anniversary date with 45 days prior written notice.

Section 304(c) of the Federal National Mortgage Association Charter Act authorizes the Secretary of the Treasury, as a public debt transaction, to purchase obligations of the Corporation up to a maximum of \$2.25 billion outstanding at any one time. The interest rate on such obligations is to be based upon the average rate on outstanding marketable obligations of the United States as of the last day of the month preceding the date of making such purchases.

The Corporation did not utilize the commercial line of credit or the Treasury borrowing authority in 1983 or 1982.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

A summary of bonds and debentures due after one year follows:

(Dollars in millions)	December 31,			
	1983		1982	
	Weighted Average Interest Rates	Amount Outstanding	Weighted Average Interest Rates	Amount Outstanding
Maturity				
Debentures:				
1984	—%	\$ —	11.53%	\$12,225
1985	12.37	12,600	12.42	12,350
1986	11.46	10,850	11.72	7,600
1987	11.16	10,650	11.59	5,150
1988	11.00	6,345	11.55	2,100
1989-1993	10.26	4,945	9.61	2,246
1994-1998	7.10	154	7.10	154
2013	12.35	250	—	—
	11.44	45,794	11.72	41,825
Mortgage-backed Bonds:				
1984	—	—	7.30	24
1985	6.70	34	6.76	34
1986	6.39	76	6.33	77
1987	9.01	12	9.08	13
1988	9.01	12	9.11	13
1989-1993	8.70	243	8.77	251
1994-1998	9.58	17	10.91	28
1999-2002	12.05	8	12.84	24
	8.22	402	8.50	464
Capital Debentures:				
1985	11.70	500	11.70	500
1986	8.15	300	8.15	300
1989	15.25	200	15.25	200
1997	7.40	250	7.40	250
2002	8.20	280	8.20	280
		1,530		1,530
Less Discount		(20)		(21)
	10.12	1,510	10.12	1,509
Convertible Capital Debentures:				
1996	4.38	28	4.38	35
Total	11.36%	\$47,734	11.62%	\$43,833

The convertible capital debentures are convertible into 1.4 million shares of common stock at a price of \$19.63 per share, subject to adjustment in certain events. Such debentures are redeemable, at the option of the Corporation, at par.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

The 12.35 percent debentures, due in 2013, are redeemable at par, in whole or in part, at the option of the Corporation, on any interest payment date commencing December 10, 1993.

The 7.40 percent and 8.20 percent capital debentures, due in 1997 and 2002, are redeemable at par, in whole or in part, at the option of the Corporation, on any interest payment date commencing October 1, 1982 and July 10, 1988, respectively.

Pursuant to the Corporation's Charter Act and related regulations, approval of the Secretary of Housing and Urban Development is required prior to a change in the stockholding requirements for lenders or the issuance of any stock of the corporation. In addition, no debt instrument may be issued without the approval of the Secretary of the Treasury. The maximum amount of the Corporation's general obligations (those neither subordinated nor secured) outstanding at any one time may not exceed 30 times the sum of its stockholders' equity and outstanding subordinated obligations. Subordinated obligations include the capital debentures and the convertible capital debentures. The secured obligations, mortgage-backed bonds, of which \$425 million were outstanding at December 31, 1983 and \$477 million at December 31, 1982, were issued pursuant to authority contained in the Charter Act to issue and sell securities based upon mortgages set aside from the Corporation's portfolio. There is no limitation on the amount of such obligations that may be outstanding. Under the provisions of a Trust Indenture entered into as of May 15, 1970 with Government National Mortgage Association (GNMA), as amended, \$416 million of the mortgage-backed bonds outstanding at December 31, 1983 and \$428 million of the mortgage-backed bonds outstanding at December 31, 1982 are guaranteed as to principal and interest by GNMA. Trust assets of approximately \$898 million at December 31, 1983 and \$867 million at December 31, 1982, consisting of the aggregate unpaid principal balances of specified mortgages, and U.S. government and Federal Agency securities, are restricted for the payment of principal and interest on the mortgage-backed bonds and are included in the accompanying balance sheets. Interest earned on trust assets exceeds bond interest requirements.

Annual maturities of all debt for the years 1985-1989 are \$13.1, \$11.2, \$10.7, \$6.4 and \$1.4 billion, respectively.

STOCKHOLDERS' EQUITY

Transactions in common stock, additional paid-in capital, retained earnings, and treasury stock accounts for the years 1981, 1982 and 1983 are summarized as follows:

	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Treasury Stock</u>	<u>Total Stockholders' Equity</u>
	(Dollars in Thousands)				
Balance, January 1, 1981.....	\$370,735	\$270,670	\$817,748	\$(1,895)	\$1,457,258
Conversion of convertible debentures.....	2	3	—	—	5
Net loss.....	—	—	(190,370)	—	(190,370)
Dividends.....	—	—	(23,643)	—	(23,643)
Balance, December 31, 1981.....	<u>370,737</u>	<u>270,673</u>	<u>603,735</u>	<u>(1,895)</u>	<u>1,243,250</u>
Conversion of convertible debentures.....	259	565	—	—	824
Shares issued in exchange for outstanding debentures.....	39,317	34,512	—	—	73,829
Net loss.....	—	—	(104,865)	—	(104,865)
Dividends.....	—	—	(9,709)	—	(9,709)
Balance, December 31, 1982.....	<u>410,313</u>	<u>305,750</u>	<u>489,161</u>	<u>(1,895)</u>	<u>1,203,329</u>
Conversion of convertible debentures.....	2,429	5,163	—	—	7,592
Net income.....	—	—	75,492	—	75,492
Dividends.....	—	—	(10,502)	—	(10,502)
Balance, December 31, 1983.....	<u>\$412,742</u>	<u>\$310,913</u>	<u>\$554,151</u>	<u>\$(1,895)</u>	<u>\$1,275,911</u>

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

In 1982, the Corporation adopted a performance share plan that makes awards to officers for three four-year periods starting in 1982, 1983 and 1984, provided certain financial goals are attained. Generally, contingent shares will be issued, if earned, half in cash and half in stock, but no more than 200,000 shares of common stock will be distributed under the plan. Accordingly, as of December 31, 1983, 175,000 contingent performance shares are outstanding for the 1982-85 period, and 64,200 for the 1983-86 period.

In September 1982, the Corporation entered into a nontaxable transaction which resulted in the issuance of 6.3 million shares of its common stock in exchange for \$101 million of its long-term debentures, which were retired. Had this transaction and all conversions of convertible debentures during the year taken place on January 1, 1982, the net loss per share for 1982 would have been \$1.56 (\$2.00 before extraordinary item), compared with a loss of \$1.72 per share (\$2.20 before extraordinary item) as reported in the Statements of Operations.

INCOME TAXES

Deferred Federal income tax expense relating to timing differences consists of the following:

	<u>1983</u>	<u>1982</u>	<u>1981</u>
	(Dollars in millions)		
Amortization of purchase discount	\$52.9	\$71.3	\$ 48.9
Losses on dispositions of mortgages	44.5	(3.9)	35.9
Provision for losses—conventional mortgages	(7.9)	0.8	19.7
Risk management activities	(9.4)	6.3	—
Other items, net	(1.7)	3.0	(2.7)
Total deferred Federal income tax expense	<u>\$78.4</u>	<u>\$77.5</u>	<u>\$101.8</u>

The Internal Revenue Service has completed its examinations of the Corporation's Federal income tax returns for the years 1979-1982, and has proposed certain adjustments. The Corporation has filed a protest contesting these adjustments, and has filed a claim for refund for \$124.9 million relating to losses on sales of participation interests in mortgages. In addition, the Corporation plans to file amended returns for 1981 and 1982 to claim losses sustained on mortgages exchanged pursuant to the Corporation's resale/refinance program. Such amended returns will result in a claim for refund of an additional \$15.2 million for losses carried back to 1979. Losses claimed in excess of the amount carried back are sufficient to offset all 1983 taxable income. Remaining losses would be carried forward to reduce future taxable income.

All disputed amounts relate to items for which deferred taxes have been provided. It is management's opinion that any unfavorable determinations would have no material adverse impact on the results of operations.

The Corporation is exempt from state and local taxes, with the exception of real estate taxes.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

RETIREMENT PLANS

All permanent, full-time employees of the Corporation are covered by the non-contributory Federal National Mortgage Association Retirement Plan or the contributory Civil Service Retirement Law. Pension expenses for these plans were \$.6 million and \$.2 million, respectively, for the year ended December 31, 1983 (\$.8 million and \$.2 million in 1982, and \$2.5 million and \$.3 million in 1981). The Corporation makes annual contributions to the plans equal to the amounts accrued for pension expense, which includes, as to the Corporation's defined benefit pension plan, amortization over 10 years of unfunded past service costs. Accumulated plan benefits, total actuarial liabilities and plan assets for the Corporation's defined benefit pension plan at January 1 are presented below:

	<u>1983</u>	<u>1982</u>
	(Dollars in millions)	
Actuarial present value of accumulated plan benefits:		
Vested	\$ 5.8	\$ 4.1
Nonvested	<u>1.7</u>	<u>1.8</u>
Total accumulated benefits	<u>\$ 7.5</u>	<u>\$ 5.9</u>
Total actuarial liability	<u>\$19.4</u>	<u>\$16.7</u>
Net assets available for benefits	<u>\$28.4</u>	<u>\$23.1</u>

The annual rate of return and the actuarial present value rate for determining accumulated plan benefits were 7.5 percent in 1983 and 1982. The rates were changed to 7.5 percent in 1982 from 6.0 percent in 1981. The changes had the effect of reducing the annual pension expense for 1982 by \$1.6 million.

COMMITMENTS AND CONTINGENCIES

Portfolio

The Corporation had outstanding at December 31, 1983 mandatory delivery commitments for the purchase of \$1.7 billion of mortgages at an average net yield of 12.36 percent compared with \$3.3 billion at 12.85 percent at December 31, 1982.

The Corporation also issues standby commitments, which must be converted to mandatory delivery commitments in order for the seller to deliver mortgages. The yield is set on the date of conversion. The Corporation had \$3.7 billion of such commitments outstanding at December 31, 1983, compared with \$3.9 billion at December 31, 1982.

Further, the Corporation issues certain commitments under which delivery is optional at the discretion of the seller, and the yield is set on the date of the commitment. The Corporation had \$0.1 billion of such commitments at an average net yield of 12.29 percent outstanding at December 31, 1983, compared with \$0.4 billion (including \$0.1 billion relating to mortgages to be refinanced) at 13.43 percent at December 31, 1982.

Mortgage-Backed Securities

The Corporation packages pools of mortgages in pass-through securities (Federal National Mortgage Association Mortgage-Backed Certificates) and guarantees the payment of principal and interest. The outstanding principal balance of the pools was \$25.1 billion at December 31, 1983 compared with \$14.5 billion at December 31, 1982. These securities represent interests primarily in fixed-rate mortgages held in trust by the Corporation. The pools of mortgages are not assets of the Corporation nor are the outstanding

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

securities liabilities of the Corporation. The Corporation as issuer and guarantor of the mortgage-backed securities is obligated to disburse scheduled monthly installments of principal and interest, whether or not such amounts have actually been received, unscheduled principal payments when received, and the full principal balance upon liquidation of any foreclosed mortgage whether or not such principal balance is recovered. Either the Corporation or the participating lender from whom the mortgages were acquired can assume the foreclosure loss risk on the mortgages in a pool. The Corporation establishes by charges to income a liability for estimated foreclosure losses for the securities on which the corporation has assumed the risk of loss. The outstanding principal balance of mortgage-backed securities on which the Corporation has the foreclosure loss risk was \$7.2 billion at December 31, 1983 compared with \$3.1 billion at December 31, 1982. The amount of the related liability for estimated foreclosure losses was \$15.6 million at December 31, 1983 and \$4.7 million at December 31, 1982.

At December 31, 1983, the Corporation had commitments outstanding to issue and guarantee \$1.6 billion of mortgage-backed securities when the related mortgages are delivered by participating lenders at their option, compared with \$2.2 billion at December 31, 1982. At December 31, 1982 the Corporation also had \$0.1 billion in outstanding mandatory delivery commitments to issue guaranteed mortgage-backed securities. There were no such commitments outstanding at December 31, 1983.

UNAUDITED INTERIM PERIOD RESULTS OF OPERATIONS

The following unaudited results of operations include, in the opinion of management, all adjustments (consisting only of normal recurring accruals) necessary for a fair statement of the results of operations for such periods.

	1983 Quarter Ended			
	December	September	June	March
	(Dollars in thousands, except per share amounts)			
Interest margin	\$ (1,386)	\$ (18,730)	\$ (11,974)	\$ (29,411)
Commitment fees	23,890	44,680	42,862	39,793
Gain on sales of mortgages	13,476	28,454	18,445	30,313
Guaranty fees	16,125	14,585	13,003	10,605
Other income	8,000	9,656	8,657	6,309
Other expenses	<u>(35,994)</u>	<u>(32,792)</u>	<u>(30,197)</u>	<u>(29,677)</u>
Income before Federal income taxes	24,111	45,853	40,796	27,932
Federal income taxes	<u>10,500</u>	<u>21,000</u>	<u>18,800</u>	<u>12,900</u>
Net income	<u>\$ 13,611</u>	<u>\$ 24,853</u>	<u>\$ 21,996</u>	<u>\$ 15,032</u>
Per share:				
Net earnings:				
Primary(a)	\$.21	\$.38	\$.34	\$.23
Fully diluted .....	.20	.37	.34	.22
Cash dividends .....	.04	.04	.04	.04

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Continued

	1982 Quarter Ended			
	December	September	June	March
	(Dollars in thousands, except per share amounts)			
Interest margin	\$(77,464)	\$(144,514)	\$(147,454)	\$(137,024)
Commitment fees	57,070	56,845	80,333	69,665
Gain on sales of mortgages	18,259	22,943	2,398	805
Guaranty fees	7,613	4,624	2,611	1,276
Other income	5,539	6,950	4,400	3,728
Other expenses	(31,083)	(24,771)	(22,233)	(17,680)
Loss before Federal income taxes and extraordinary item	(20,066)	(77,923)	(79,945)	(79,230)
Federal income taxes	(14,400)(b)	(35,800)	(36,800)	(36,400)
Loss before extraordinary item	(5,666)	(42,123)	(43,145)	(42,830)
Extraordinary item: Gain on early retirement of debt	—	28,899(c)	—	—
Net loss	\$ (5,666)	\$ (13,224)	\$ (43,145)	\$ (42,830)
Per share:				
Loss before extraordinary item(a)	\$ (.09)	\$ (.71)	\$ (.73)	\$ (.72)
Net loss(a)	(.09)	(.22)	(.73)	(.72)
Cash dividends .....	.04	.04	.04	.04

(a) The total of the four quarters does not equal the amount for the year since the amount for each period is independently calculated based on the weighted average number of shares outstanding during that period. In 1982, there were no differences between primary and fully diluted loss per share.

(b) Federal legislation that alters the Corporation's tax status to give it a tax loss carryback and carryforward treatment for operating losses comparable to that of other financial institutions (10-year carryback and 5-year carryforward) was enacted in October, 1982. This legislation gives the Corporation access to refunds not otherwise available. Federal income taxes recorded in the fourth quarter of 1982 include an appropriate adjustment for this change in circumstances.

(c) In September 1982, the Corporation entered into a nontaxable transaction which resulted in the issuance of 6.3 million shares of its common stock in exchange for \$101 million of its long-term debentures, which were retired.

UNAUDITED FINANCIAL DATA ADJUSTED FOR EFFECTS OF CHANGING PRICES

The Corporation is subject to a requirement, promulgated by the Financial Accounting Standards Board (FASB), that it provide supplementary financial information which is intended to disclose the impact of changing prices (inflation) on its financial condition and the results of operations. As a financial institution, the Corporation does not maintain inventories or significant amounts of plant and equipment. Accordingly, the adjustments to income required by the statement are not material and need not be reported.

The FASB statement provides that the impact of inflation on the Corporation's financial condition be shown by reporting the loss from decline in purchasing power of its net monetary assets. For the Corporation, the definition of net monetary assets includes virtually all assets and liabilities of the Corporation. Net monetary assets are, therefore, approximately equivalent to stockholders' equity. The loss from decline in purchasing power is required to be measured by restating net monetary assets in constant dollars using the Consumer Price Index for All Urban Consumers.

FEDERAL NATIONAL MORTGAGE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS—Concluded

In accordance with the FASB statement, an unaudited five-year comparison of the impact of changing prices on certain financial data is shown below:

Financial Data Adjusted for Effects of Changing Prices

	<u>1983</u>	<u>1982</u>	<u>1981</u>	<u>1980</u>	<u>1979</u>
	(Dollars in millions, except per share amounts)				
Interest margin:					
As reported	\$ (62)	\$ (506)	\$ (463)	\$ 21	\$ 322
In constant dollars(1)	(62)	(523)	(507)	25	442
Net income (loss):					
As reported	75	(105)	(190)	14	162
In constant dollars(1)	75	(108)	(209)	17	222
Net monetary assets at end of year:					
As reported	1,233	1,164	1,204	1,419	1,461
In constant dollars(1)	1,207	1,184	1,272	1,636	1,892
Loss in purchasing power for the year of average net monetary assets	46	46	129	204	239
Per share:					
Fully diluted earnings(loss):					
As reported	1.13	(1.72)	(3.22)	.23	2.68
In constant dollars(1)	1.13	(1.78)	(3.53)	.28	3.68
Cash dividends:					
As reported .....	.16	.16	.40	1.12	1.28
In constant dollars(1) .....	.16	.17	.44	1.35	1.76
Year-end market price:					
As reported	23.00	24.50	8.50	11.88	16.13
In constant dollars(1)	22.52	24.93	8.98	13.70	20.88
Average consumer price index	298.5	289.1	272.4	246.8	217.4

(1) Constant dollars are computed by reference to the Consumer Price Index for All Urban Consumers and are expressed in average 1983 dollars.







