

OFFERING CIRCULAR

8,000,000 Shares



**5.81% Non-Cumulative Preferred Stock, Series H
(stated value \$50 per share)**

This Offering Circular relates to the offer of 8,000,000 shares of the 5.81% Non-Cumulative Preferred Stock, Series H (the “Preferred Stock”) of the Federal National Mortgage Association (“Fannie Mae”). The Preferred Stock has a stated value and liquidation preference of \$50 per share. Dividends at the rate of 5.81% per year will accrue from and including April 6, 2001. We will be required to pay dividends quarterly on March 31, June 30, September 30 and December 31 of each year, commencing June 30, 2001. However, we will be required to pay dividends only when, as and if declared by our Board of Directors, or a duly authorized committee thereof, in its sole discretion out of funds legally available for such payment. The amount of dividends we will be required to pay, if our Board declares them, may be increased if legislation is enacted that changes the Internal Revenue Code of 1986, as amended, to reduce the dividends-received deduction applicable to dividends on the Preferred Stock as set forth under “Description of the Preferred Stock—Dividends—Changes in the Dividends-Received Percentage.”

Dividends on the Preferred Stock will not be cumulative. Accordingly, if for any reason our Board of Directors does not declare a dividend on the Preferred Stock for a dividend period, we will have no obligation to pay a dividend for that period, whether or not our Board declares dividends on the Preferred Stock for any future dividend period. If, however, we have not paid or set aside for payment dividends on the Preferred Stock for a dividend period, we may not pay dividends on our common stock for that period.

On or after April 6, 2006, we may redeem the Preferred Stock, in whole or in part, at any time or from time to time, at our option at the redemption price of \$50 per share plus the dividend (whether or not declared) for the then-current quarterly dividend period accrued to but excluding the date of redemption.

The Preferred Stock will not have any voting rights, except as set forth under “Description of the Preferred Stock—Voting Rights; Amendments.”

We will apply to list the Preferred Stock on the New York Stock Exchange under the symbol “FNMprH.” If approved for listing, we expect trading of the Preferred Stock on the NYSE to commence within a thirty-day period after the initial delivery of the Preferred Stock.

Our obligations under the terms of the Preferred Stock are only our obligations and are not those of the United States or of any instrumentality thereof other than Fannie Mae.

	Initial Public Offering Price (1)	Underwriting Discount	Proceeds to Fannie Mae (1) (2)
Per Share	\$50.00	\$0.4375	\$49.5625
Total	\$400,000,000	\$3,500,000	\$396,500,000

(1) Plus accrued dividends, if any, from April 6, 2001.

(2) Before deducting estimated expenses of \$300,000.

Bear, Stearns & Co. Inc.

Lehman Brothers

First Tennessee Bank N.A.

Merrill Lynch & Co.

Ormes Capital Markets, Inc.

The date of this Offering Circular is April 3, 2001.

We are not required to register the Preferred Stock under the U.S. Securities Act of 1933, as amended. Accordingly, we have not filed a registration statement with the U.S. Securities and Exchange Commission. The shares of Preferred Stock are “exempted securities” within the meaning of the U.S. Securities Exchange Act of 1934, as amended. Neither the U.S. Securities and Exchange Commission nor any state securities commission has approved or disapproved the Preferred Stock or determined if this Offering Circular is truthful or complete. Any representation to the contrary is a criminal offense.

The distribution of this Offering Circular and the offer, sale, and delivery of the Preferred Stock in certain jurisdictions may be restricted by law. Persons who come into possession of this Offering Circular must inform themselves about and observe any applicable restrictions.

This Offering Circular is not an offer to sell or a solicitation of an offer to buy any securities other than the Preferred Stock or an offer to sell or a solicitation of an offer to buy the Preferred Stock in any jurisdiction or in any other circumstance in which an offer or solicitation is unlawful or not authorized.

Because we are not subject to the periodic reporting requirements of the U.S. Securities Exchange Act of 1934, we do not file reports or other information with the U.S. Securities and Exchange Commission.

No person has been authorized to give any information or make any representations other than those contained in this Offering Circular and, if given or made, such information or representations must not be relied upon as having been authorized. Neither the delivery of this Offering Circular nor any sale made hereunder shall, under any circumstances, create an implication that there has been no change in the affairs of Fannie Mae since the date hereof, or in the case of facts set forth in the documents incorporated by reference herein, since the respective dates thereof or that the information contained herein or therein is correct as to any time subsequent thereto.

TABLE OF CONTENTS

<u>Description</u>	<u>Page</u>
Summary of the Offering	3
Fannie Mae	6
Use of Proceeds	6
Capitalization	7
Selected Financial Information	8
Government Regulation and Charter Act	10
Description of the Preferred Stock	13
Legality of Investment	19
United States Taxation	20
Underwriting	22
Rating	23
Accountants	23
Validity of the Preferred Stock	23
Additional Information About Fannie Mae	23
Certificate of Designation	Appendix A
Information Statement dated March 30, 2001	Appendix B

SUMMARY OF THE OFFERING

This summary highlights information contained elsewhere in, or incorporated by reference in, this Offering Circular. It does not contain all of the information you should consider before investing in the Preferred Stock. You also should read the more detailed information contained elsewhere in this Offering Circular and in the documents incorporated herein by reference.

Fannie Mae

Fannie Mae is a federally chartered and stockholder-owned corporation organized and existing under the Federal National Mortgage Association Charter Act. We are the largest investor in home mortgage loans in the United States. We were established in 1938 as a United States government agency to provide supplemental liquidity to the mortgage market and were transformed into a stockholder-owned and privately managed corporation by legislation enacted in 1968.

Description of the Preferred Stock

Issuer	Fannie Mae
Securities Offered	8,000,000 shares of 5.81% Non-Cumulative Preferred Stock, Series H, no par value, with a stated value and liquidation preference of \$50 per share.
Dividends:	
Dividend Rate	5.81% per annum. Non-cumulative quarterly cash dividends at the rate of 5.81% per year will accrue from and including April 6, 2001.
Frequency of Payment	Quarterly, when, as and if declared by the Board of Directors in its sole discretion, but only out of funds legally available for the payment of dividends.
Payment Dates	March 31, June 30, September 30, and December 31 of each year, commencing June 30, 2001.
DRD Protection	If, prior to October 6, 2002, amendments to the Internal Revenue Code of 1986, as amended, are enacted that eliminate or reduce the percentage of the dividends-received deduction below 70%, the amount of dividends payable in respect of the Preferred Stock will be adjusted to offset the effect of such reduction. However, no adjustment will be made to the extent that the percentage of the dividends-received deduction is reduced below 50%.
Preferences	The Preferred Stock will be entitled to a preference, both as to dividends and upon liquidation, over the common stock (and any other junior stock) of Fannie Mae. The Preferred Stock will rank equally, both as to dividends and upon liquidation, with all other currently outstanding series of Fannie Mae preferred stock.
Optional Redemption	On or after April 6, 2006, we may redeem the Preferred Stock, in whole or in part, at any time or from time to time, at our option at the redemption price of \$50 per share plus an amount equal to the dividend for the then-current quarterly dividend period accrued to but excluding the date of redemption (whether or not declared, but without accumulation of any dividends for prior dividend periods). Holders of Preferred Stock will have no right to require redemption of Preferred Stock.

Liquidation Rights	In the event of any dissolution or liquidation of Fannie Mae, holders of the Preferred Stock will be entitled to receive, out of any assets available for distribution to stockholders, \$50 per share plus the dividend for the then-current quarterly dividend period accrued through the liquidation payment date.
Voting Rights	None, except with respect to certain changes in the terms of the Preferred Stock
Preemptive and Conversion Rights	None
Rating	The Preferred Stock has been rated “AA–” by Standard & Poor’s Ratings Group, a Division of the McGraw-Hill Companies and “aa3” by Moody’s Investors Service, Inc.
Use of Proceeds	To be added to the working capital of Fannie Mae and used for general corporate purposes, including the repurchase of outstanding shares of our preferred stock.
Transfer Agent, Dividend Disbursing Agent and Registrar	First Chicago Trust Company a division of EquiServe
NYSE Listing	We will apply to list the Preferred Stock on the New York Stock Exchange under the symbol “FNMprH”. If approved for listing, we expect trading on the NYSE to commence within a thirty-day period after the initial delivery of the Preferred Stock.
CUSIP Number	313586885

Summary Selected Financial Data
(Dollars in millions)

	December 31,				
	2000	1999	1998	1997	1996
Balance Sheet Data:					
Mortgage portfolio, net	\$ 607,399	\$522,780	\$415,223	\$316,316	\$286,259
Total assets	675,072	575,167	485,014	391,673	351,041
Total liabilities	654,234	557,538	469,561	377,880	338,268
Stockholders' equity	20,838	17,629	15,453	13,793	12,773
Capital(1)	21,645	18,430	16,244	14,575	13,520
Core capital(2)	20,827	17,876	15,465	13,793	12,773
	Year Ended December 31,				
	2000	1999	1998	1997	1996
Income Statement Data:					
Net interest income	\$ 5,674	\$ 4,894	\$ 4,110	\$ 3,949	\$ 3,592
Guaranty fee income	1,351	1,282	1,229	1,274	1,196
Fee and other income (expense)	(44)	191	275	125	86
Net income	4,448	3,912	3,418	3,056	2,725
	Year Ended December 31,				
	2000	1999	1998	1997	1996
Other Data:					
Taxable-equivalent revenues(3)	\$ 7,825	\$ 6,975	\$ 6,272	\$ 5,735	\$ 5,216
Net interest margin	1.01%	1.01%	1.03%	1.17%	1.18%
Ratio of earnings to combined fixed charges and preferred stock dividends(4)	1.16:1	1.17:1	1.18:1	1.19:1	1.19:1
Mortgage purchases	\$ 154,231	\$195,210	\$188,448	\$ 70,465	\$ 68,618
MBS issued	211,662	300,689	326,148	149,429	149,869
MBS outstanding at year-end(5)	1,057,750	960,883	834,518	709,582	650,780

- (1) Stockholders' equity plus general allowance for losses at period end.
- (2) The sum of (a) the stated value of outstanding common stock, (b) the stated value of outstanding non-cumulative perpetual preferred stock, (c) paid-in capital, and (d) retained earnings.
- (3) Includes revenues net of operating losses plus taxable-equivalent adjustments for tax-exempt income and investment tax credits using the applicable federal income tax rate.
- (4) "Earnings" consists of (a) income before federal income taxes and extraordinary item and (b) fixed charges. "Fixed charges" represents interest expense.
- (5) Includes MBS in portfolio of \$351 billion, \$282 billion, \$197 billion, \$130 billion, and \$103 billion at December 31, 2000, 1999, 1998, 1997, and 1996, respectively.

FANNIE MAE

Fannie Mae is a federally chartered and stockholder-owned corporation organized and existing under the Federal National Mortgage Association Charter Act, 12 U.S.C. § 1716 *et seq.* (the “Charter Act”). See “Government Regulation and Charter Act” in this Offering Circular and in the Information Statement and “Additional Information About Fannie Mae” in this Offering Circular. We are the largest investor in home mortgage loans in the United States. We were established in 1938 as a United States government agency to provide supplemental liquidity to the mortgage market and were transformed into a stockholder-owned and privately managed corporation by legislation enacted in 1968.

Fannie Mae provides funds to the mortgage market by purchasing mortgage loans from lenders, thereby replenishing their funds for additional lending. We acquire funds to purchase these loans by issuing debt securities to capital market investors, many of whom ordinarily would not invest in mortgages. In this manner, we are able to expand the total amount of funds available for housing.

Fannie Mae also issues mortgage-backed securities (“MBS”), receiving guaranty fees for our guarantee of timely payment of principal and interest on MBS certificates. We issue MBS primarily in exchange for pools of mortgage loans from lenders. The issuance of MBS enables us to further our statutory purpose of increasing the liquidity of residential mortgage loans.

In addition, Fannie Mae offers various services to lenders and others for a fee. These services include issuing certain types of MBS and credit enhancements and providing technology services for originating and underwriting loans. See “Business” in the Information Statement and “Additional Information About Fannie Mae” in this Offering Circular.

Fannie Mae’s principal office is located at 3900 Wisconsin Avenue, N.W., Washington, D.C. 20016 (telephone: (202) 752-7000).

USE OF PROCEEDS

We will add the net proceeds from the sale of the Preferred Stock to our working capital and use them for general corporate purposes, including the repurchase of shares of our preferred stock. We anticipate the need for additional financing from time to time, including financing through various types of equity and debt securities. The amount and nature of such financings will depend upon a number of factors, including the volume of our maturing debt obligations, the volume of mortgage loan prepayments, the volume and type of mortgage loans we purchase, and general market conditions.

CAPITALIZATION

The following table sets forth our capitalization as of December 31, 2000, and it is adjusted to give effect to the issuance of the Preferred Stock (before giving effect to the payment of estimated offering expenses and underwriting discount), without giving effect to the redemption of our 6.41% Non-Cumulative Preferred Stock, Series A, on March 1, 2001.

	Average Maturity	Average Cost (1)	Actual Outstanding at December 31, 2000	As Adjusted
			(Dollars in millions)	
Debtures, notes, and bonds, net:				
Due within one year:				
Short-term notes	3 mos.	6.50%	\$178,292	\$178,292
Universal Benchmark	5 mos.	5.71	6,984	6,984
Universal Retail	3 mos.	6.62	785	785
Universal Short-term	6 mos.	6.58	42,157	42,157
Universal Standard	9 mos.	6.02	51,185	51,185
Other (2)		6.57	919	919
Total due within one year			280,322	280,322
Due after one year:				
Universal Benchmark	7 yrs. 2 mos.	6.42%	185,771	185,771
Universal Retail	6 yrs. 9 mos.	6.82	7,083	7,083
Universal Standard	5 yrs.	6.42	165,680	165,680
Other	16 yrs.	8.58	3,826	3,826
Total due after one year			362,360	362,360
Total debentures, notes, and bonds			\$642,682	\$642,682
Stockholders' equity:				
Preferred stock, \$50 stated value;				
100,000,000 shares authorized—				
45,550,000 shares issued at				
December 31, 2000; 53,550,000 shares				
issued as adjusted				
Series A, 7,500,000 shares issued (3) ..			\$ 375	\$ 375
Series B, 7,500,000 shares issued			375	375
Series C, 5,000,000 shares issued			250	250
Series D, 3,000,000 shares issued			150	150
Series E, 3,000,000 shares issued			150	150
Series F, 13,800,000 shares issued			690	690
Series G, 5,750,000 shares issued			288	288
Series H, 8,000,000 shares issued			—	400
Common stock, \$.525 stated value, no				
maximum authorization—				
1,129,000,000 shares outstanding			593	593
Additional paid-in capital			1,588	1,588
Retained earnings			21,619	21,619
Accumulated other comprehensive income			10	10
			26,088	26,488
Less treasury stock, at cost—				
130,000,000 shares (4)			5,250	5,250
Total stockholders' equity			\$ 20,838	\$ 21,238

- (1) Represents weighted-average cost, which includes the amortization of discounts, premiums, issuance costs, hedging results, and the effects of currency and debt swaps.
- (2) Average maturity is indeterminate because the outstanding amount includes investment agreements that have varying maturities.
- (3) Fannie Mae redeemed all of the outstanding shares of its 6.41% Non-Cumulative Preferred Stock, Series A, on March 1, 2001 at \$50.53 per share. The redemption price included dividends of \$.53417 per share commencing December 31, 2000, up to but excluding March 1, 2001.
- (4) Does not reflect any repurchases of our common stock that may be made using proceeds from the sale of the Preferred Stock, Series H. See "Use of Proceeds."

We frequently issue debentures, notes, and other debt obligations, and from time to time we redeem such debt obligations. The amount of debentures, notes, other debt obligations outstanding, and stockholders' equity on any date subsequent to December 31, 2000 may differ from that shown in the table above.

SELECTED FINANCIAL INFORMATION

The following selected financial data for the years 1996 through 2000 (which data are not covered by the independent auditors' report) have been summarized or derived from our audited financial statements and other financial information for such years. These data should be read in conjunction with the audited financial statements and notes to the financial statements contained in the Information Statement incorporated herein by reference and included in this Offering Circular as Appendix B.

(Dollars in millions, except per common share amounts)

	Year Ended December 31,				
	2000	1999	1998	1997	1996
Income Statement Data:					
Interest income	\$ 42,781	\$ 35,495	\$ 29,995	\$ 26,378	\$ 23,772
Interest expense	(37,107)	(30,601)	(25,885)	(22,429)	(20,180)
Net interest income	5,674	4,894	4,110	3,949	3,592
Guaranty fee income	1,351	1,282	1,229	1,274	1,196
Fee and other income (expense)	(44)	191	275	125	86
Credit-related expenses	(94)	(127)	(261)	(375)	(409)
Administrative expenses	(905)	(800)	(708)	(636)	(560)
Income before federal income taxes and extraordinary item	5,982	5,440	4,645	4,337	3,905
Provision for federal income taxes	(1,566)	(1,519)	(1,201)	(1,269)	(1,151)
Income before extraordinary item	4,416	3,921	3,444	3,068	2,754
Extraordinary item—gain (loss) on early extinguishment of debt, net of tax effect	32	(9)	(26)	(12)	(29)
Net income	<u>\$ 4,448</u>	<u>\$ 3,912</u>	<u>\$ 3,418</u>	<u>\$ 3,056</u>	<u>\$ 2,725</u>
Preferred stock dividends	(121)	(78)	(66)	(65)	(42)
Net income available to common shareholders ...	<u>\$ 4,327</u>	<u>\$ 3,834</u>	<u>\$ 3,352</u>	<u>\$ 2,991</u>	<u>\$ 2,683</u>
Basic earnings per common share(1):					
Earnings before extraordinary item	\$ 4.28	\$ 3.75	\$ 3.28	\$ 2.87	\$ 2.53
Extraordinary item .....	.03	—	(.02)	(.02)	(.03)
Net earnings	<u>\$ 4.31</u>	<u>\$ 3.75</u>	<u>\$ 3.26</u>	<u>\$ 2.85</u>	<u>\$ 2.50</u>
Diluted earnings per common share(1):					
Earnings before extraordinary item	\$ 4.26	\$ 3.73	\$ 3.26	\$ 2.84	\$ 2.51
Extraordinary item .....	.03	(.01)	(.03)	(.01)	(.03)
Net earnings	<u>\$ 4.29</u>	<u>\$ 3.72</u>	<u>\$ 3.23</u>	<u>\$ 2.83</u>	<u>\$ 2.48</u>
Cash dividends per common share	\$ 1.12	\$ 1.08	\$.96	\$.84	\$.76
	December 31,				
	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
Balance Sheet Data:					
Mortgage portfolio, net	\$607,399	\$522,780	\$415,223	\$316,316	\$286,259
Investments	54,968	39,751	58,515	64,596	56,606
Total assets	675,072	575,167	485,014	391,673	351,041
Borrowings:					
Due within one year	280,322	226,582	205,413	175,400	159,900
Due after one year	362,360	321,037	254,878	194,374	171,370
Total liabilities	654,234	557,538	469,561	377,880	338,268
Stockholders' equity	20,838	17,629	15,453	13,793	12,773
Capital(2)	21,645	18,430	16,244	14,575	13,520
Core capital(3)	20,827	17,876	15,465	13,793	12,773

	Year Ended December 31,				
	2000	1999	1998	1997	1996
Other Data:					
Taxable-equivalent revenues(4)	\$ 7,825	\$ 6,975	\$ 6,272	\$ 5,735	\$ 5,216
Net interest margin	1.01%	1.01%	1.03%	1.17%	1.18%
Return on average common equity	25.6	25.2	25.2	24.6	24.1
Dividend payout ratio	26.0	28.8	29.5	29.4	30.4
Average effective guaranty fee rate .....	.195	.193	.202	.227	.224
Credit loss ratio .....	.007	.011	.027	.041	.053
Ratio of earnings to combined fixed charges and preferred stock dividends(5)	1.16:1	1.17:1	1.18:1	1.19:1	1.19:1
Mortgage purchases	\$ 154,231	\$195,210	\$188,448	\$ 70,465	\$ 68,618
MBS issued	211,662	300,689	326,148	149,429	149,869
MBS outstanding at year-end(6)	1,057,750	960,883	834,518	709,582	650,780
Weighted-average diluted common shares outstanding, in millions	1,009	1,031	1,037	1,056	1,080

(1) Earnings per common share amounts for 1996 have been restated to comply with Statement of Financial Accounting Standards No. 128, *Earnings per Share*.

(2) Stockholders' equity plus general allowance for losses.

(3) The sum of (a) the stated value of outstanding common stock, (b) the stated value of non-cumulative perpetual preferred stock, (c) paid-in capital, and (d) retained earnings.

(4) Includes revenues net of operating losses plus taxable-equivalent adjustments for tax-exempt income and investment tax credits using the applicable federal income tax rate.

(5) "Earnings" consists of (a) income before federal income taxes and extraordinary item and (b) fixed charges. "Fixed charges" represents interest expense.

(6) Includes MBS in portfolio of \$351 billion, \$282 billion, \$197 billion, \$130 billion, and \$103 billion at December 31, 2000, 1999, 1998, 1997, and 1996, respectively.

GOVERNMENT REGULATION AND CHARTER ACT

Fannie Mae is a federally chartered and stockholder-owned corporation organized and existing under the Charter Act (12 U.S.C. § 1716 *et seq.*) whose purpose is to (1) provide stability in the secondary market for residential mortgages, (2) respond appropriately to the private capital market, (3) provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing, and (4) promote access to mortgage credit throughout the nation (including central cities, rural areas and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing.

Fannie Mae originally was incorporated in 1938 pursuant to Title III of the National Housing Act as a wholly-owned government corporation and in 1954, under a revised Title III called the Federal National Mortgage Association Charter Act, became a mixed-ownership corporate instrumentality of the United States. From 1950 to 1968, it operated in the Housing and Home Finance Agency, which was succeeded by the Department of Housing and Urban Development (“HUD”). Pursuant to amendments to the Charter Act enacted in the Housing and Urban Development Act of 1968 (the “1968 Act”), the then Federal National Mortgage Association was divided into two separate institutions, the present Fannie Mae and the Government National Mortgage Association, a wholly owned corporate instrumentality of the United States within HUD, which carried on certain special financing assistance and management and liquidation functions. Under the 1968 Act, Fannie Mae was constituted as a federally chartered corporation and the entire equity interest in Fannie Mae became stockholder-owned.

Although the 1968 Act eliminated all federal ownership interest in Fannie Mae, it did not terminate government regulation of Fannie Mae. Under the Charter Act, approval of the Secretary of the Treasury is required for Fannie Mae’s issuance of its debt obligations and MBS. In addition, the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the “1992 Act”) established the Office of Federal Housing Enterprise Oversight (“OFHEO”), an independent office within HUD under the management of a Director (the “Director”) who is responsible for ensuring that Fannie Mae and the Federal Home Loan Mortgage Corporation, or “Freddie Mac,” are adequately capitalized and operating safely in accordance with the 1992 Act. The Director is authorized to levy, pursuant to annual Congressional appropriations, annual assessments on Fannie Mae and Freddie Mac to cover reasonable expenses of OFHEO. The 1992 Act established minimum capital, risk-based capital, and critical capital requirements for Fannie Mae and required the Director to establish, by regulation, a risk-based capital test to be used to determine the amount of total capital Fannie Mae must hold to meet the risk-based capital standard on a quarterly basis. OFHEO issued a final rule (the “Rule”) in 1996 related to the minimum capital levels for Fannie Mae and Freddie Mac that sets forth how minimum capital requirements for both entities are to be calculated, reported, and classified on a quarterly basis. The Rule formalized the interim capital standards applied by OFHEO, with which Fannie Mae has been in compliance since their inception. See also “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Regulatory Environment” in the Information Statement.

OFHEO has proposed regulations to establish the risk-based capital test for Fannie Mae and Freddie Mac in two parts. Part I specifies that “benchmark loss experience” will be combined with other yet to be determined assumptions and applied each quarter to Fannie Mae’s book of business to establish credit losses under the risk-based capital standard for Fannie Mae. Part I also specifies the house price index that OFHEO will use in connection with the risk-based capital standard. Fannie Mae submitted comments on Part I stating that several aspects of the initial proposal require adjustments or amendment, because it does not accurately capture Fannie Mae’s credit history and derives credit loss rates that are significantly worse than any reasonable representation of Fannie

Mae's and Freddie Mac's loss experience. Part II specifies, among other matters, remaining aspects of the test and how the test will be used to determine Fannie Mae's and Freddie Mac's risk-based capital requirements. The summary accompanying Part II noted that if Part II had been in effect as of June 30, 1997, Fannie Mae's required risk-based capital would have been \$17.73 billion, as compared with \$14.05 billion in actual capital at that time. OFHEO also noted that there were a variety of means, such as hedging, that Fannie Mae could have used to reduce required risk-based capital to the level of its actual capital. Fannie Mae submitted comments on Part II detailing three principal criteria that management used to evaluate Part II of the proposed regulations: operational workability, the ability to accommodate innovation, and linking of capital to risk. Management concluded that OFHEO's proposed regulations failed to meet these three criteria and made suggestions for addressing these points. Management believes that the final risk-based standard could be modified substantially from its current proposed form. The 1992 Act provides that the final regulations will be enforceable one year after issuance. Management expects that Fannie Mae will be able to meet any reasonable final test.

If Fannie Mae fails to meet one or more of the capital standards under the 1992 Act, the Director is required to take certain remedial measures and may take others, depending on the standards Fannie Mae fails to meet. The Director's enforcement powers include the power to impose temporary and final cease-and-desist orders and civil penalties on Fannie Mae and on directors or executive officers of Fannie Mae. If the Director determines that Fannie Mae is engaging in conduct not approved by the Director that could result in a rapid depletion of core capital or that the value of the property subject to mortgages held or securitized by Fannie Mae has decreased significantly, the Director is authorized to treat Fannie Mae as not meeting one of the capital standards that it otherwise meets. In addition, Fannie Mae is required to submit a capital restoration plan if it fails to meet any of the capital standards. If the Director does not approve the plan or determines that Fannie Mae has failed to make reasonable efforts to comply with the plan, then the Director may treat Fannie Mae as not meeting one of the capital standards that it otherwise meets. Also, if Fannie Mae fails to meet or is treated by the Director as not meeting one of the capital standards and the Director has reasonable cause to believe that Fannie Mae or any executive officer or director of Fannie Mae is engaging in or about to engage in any conduct that threatens to result in a significant depletion of Fannie Mae's core capital, then the Director is authorized to commence proceedings pursuant to which, after a hearing, the Director could issue a cease and desist order prohibiting such conduct. The Director could issue such an order without a hearing, which would be effective until completion of the cease-and-desist proceedings, if the Director determined that the conduct in question was likely to cause a significant depletion of core capital. Prior approval of the Director is required for Fannie Mae to pay a dividend if the dividend would decrease Fannie Mae's capital below risk-based capital or minimum capital levels established under the 1992 Act. See "Common and Preferred Stock" in the Information Statement.

The 1992 Act gives the Director the authority to conduct on-site examinations of Fannie Mae for purposes of ensuring Fannie Mae's financial safety and soundness. The Charter Act, as amended by the 1992 Act, also authorizes the General Accounting Office to audit the programs, activities, receipts, expenditures, and financial transactions of Fannie Mae. Fannie Mae is required to submit annual and quarterly reports of the financial condition and operations of Fannie Mae to the Director. Fannie Mae also is required to submit an annual report to the House and Senate Banking Committees and the Secretary of HUD regarding Fannie Mae's performance in meeting housing goals relating to the purchase of mortgages on housing for low- and moderate-income families, mortgages on rental and owner-occupied housing for low-income families in low-income areas or for very-low-income families, and mortgages on housing located in rural or other underserved areas. The Secretary of HUD has recently proposed new housing goals for Fannie Mae. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Housing Goals" in the Information Statement.

Under the 1992 Act, the Secretary of HUD retains general regulatory authority to promulgate rules and regulations to carry out the purposes of the Charter Act, excluding authority over matters granted exclusively to the Director of OFHEO in the 1992 Act. The Secretary of HUD also must

approve any new conventional mortgage program that is significantly different from those approved or engaged in prior to the 1992 Act. The Secretary is required to approve any new program unless it is not authorized by the Charter Act of Fannie Mae or the Secretary finds that it is not in the public interest. However, until one year after the final regulations establishing the risk-based capital test are in effect, the Secretary must disapprove a new program if the Director determines that the program would risk significant deterioration of the financial condition of Fannie Mae. The Secretary has adopted regulations related to the program approval requirement.

Thirteen members of Fannie Mae's eighteen-member Board of Directors are elected by the holders of Fannie Mae's common stock, and the remaining five members are appointed by the President of the United States. The appointed directors must include one person from the home building industry, one person from the mortgage lending industry, and one person from the real estate industry. Under the 1992 Act, one appointed director also must be from an organization that has represented consumer or community interests for not less than two years or a person who has demonstrated a career commitment to the provision of housing for low-income households. Any member of the Board of Directors that is appointed by the President of the United States may be removed by the President for good cause.

In addition to placing Fannie Mae under federal regulation, the Charter Act also grants to Fannie Mae certain privileges. For instance, securities issued by Fannie Mae are deemed to be "exempt securities" under laws administered by the Securities and Exchange Commission (the "SEC") to the same extent as securities that are obligations of, or guaranteed as to principal and interest by, the United States. Registration statements with respect to Fannie Mae's securities are not filed with the SEC. Fannie Mae also is not required to file periodic reports with the SEC.

The Secretary of the Treasury of the United States has discretionary authority to purchase obligations of Fannie Mae up to a maximum of \$2.25 billion outstanding at any one time. This facility has not been used since Fannie Mae's transition from government ownership in 1968. Neither the United States nor any agency thereof is obligated to finance Fannie Mae's operations or to assist Fannie Mae in any other manner. The Federal Reserve Banks are authorized to act as depositaries, custodians, and fiscal agents for Fannie Mae, for its own account, or as fiduciary.

We are exempt from all taxation by any state or by any county, municipality, or local taxing authority except for real property taxes. We are not exempt from payment of federal corporate income taxes. Also, we may conduct our business without regard to any qualifications or similar statute in any state of the United States or the District of Columbia.

DESCRIPTION OF THE PREFERRED STOCK

We are authorized by the Charter Act to have preferred stock on such terms and conditions as our Board of Directors may prescribe. On December 27, 1995, our Board of Directors amended our bylaws to authorize Fannie Mae to issue up to 100,000,000 shares of preferred stock. To date, we have issued the following:

- on March 1, 1996, 7,500,000 shares of 6.41% Non-Cumulative Preferred Stock, Series A (stated value \$50 per share) (the “Series A Preferred Stock”);
- on April 12, 1996, 7,500,000 shares of 6.50% Non-Cumulative Preferred Stock, Series B (stated value \$50 per share) (the “Series B Preferred Stock”);
- on September 20, 1996, 5,000,000 shares of 6.45% Non-Cumulative Preferred Stock, Series C (stated value \$50 per share) (the “Series C Preferred Stock”);
- on September 30, 1998, 3,000,000 shares of 5.25% Non-Cumulative Preferred Stock, Series D (stated value \$50 per share) (the “Series D Preferred Stock”);
- on April 15, 1999, 3,000,000 shares of 5.10% Non-Cumulative Preferred Stock, Series E (stated value \$50 per share) (the “Series E Preferred Stock”);
- on March 20, 2000, 13,800,000 shares of Variable Rate Non-Cumulative Preferred Stock, Series F (stated value \$50 per share) (the “Series F Preferred Stock”); and
- on August 8, 2000, 5,750,000 shares of Variable Rate Non-Cumulative Preferred Stock, Series G (stated value \$50 per share) (the “Series G Preferred Stock”).

We redeemed all of our outstanding Series A Preferred Stock on March 1, 2001. In this Offering Circular, we refer to the Series B Preferred Stock through the Series G Preferred Stock as the “Outstanding Preferred Stock.”

The terms of the Preferred Stock will be established by a Certificate of Designation of Terms of 5.81% Non-Cumulative Preferred Stock, Series H (the “Certificate of Designation”), adopted by a duly authorized committee of our Board of Directors, which will be substantially in the form attached as Appendix A to this Offering Circular. The following is a brief description of the terms of the Preferred Stock; you also should read the Certificate of Designation for a full description of the Preferred Stock.

General

We have the right to create and issue additional shares of Preferred Stock and additional classes or series of stock that rank, as to dividends, liquidation or otherwise, prior to, on parity with or junior to the Preferred Stock, without the consent of holders of the Preferred Stock. As of the date hereof, the shares of Outstanding Preferred Stock are the only shares of preferred stock of Fannie Mae outstanding. The Preferred Stock will rank equally as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae with the Outstanding Preferred Stock.

The Preferred Stock has no par value, has a stated value and liquidation preference of \$50 per share, and, upon issuance against full payment of the purchase price therefor, will be fully paid and nonassessable.

The Preferred Stock will not be subject to any mandatory redemption, sinking fund, or other similar provisions. In addition, holders of Preferred Stock will have no right to require redemption of any shares of Preferred Stock.

The Preferred Stock will not be convertible into or exchangeable for any other stock or obligations of Fannie Mae and will have no preemptive rights.

First Chicago Trust Company a division of EquiServe will be the transfer agent, dividend disbursing agent, and registrar for the shares of Preferred Stock.

The obligations of Fannie Mae under the terms of the Preferred Stock are obligations of Fannie Mae only and are not those of the United States or of any instrumentality thereof other than Fannie Mae.

Dividends

Dividends on shares of the Preferred Stock will not be mandatory. Holders of record of Preferred Stock as they appear on the books and records of Fannie Mae (the "Holders") will be entitled to receive, when, as and if declared by the Board of Directors of Fannie Mae, or a duly authorized committee thereof, in its sole discretion out of funds legally available for dividend payments, non-cumulative, quarterly cash dividends that will accrue from and including April 6, 2001 and will be payable on March 31, June 30, September 30, and December 31 of each year (each a "Dividend Payment Date"), commencing June 30, 2001, at the annual rate of \$2.9052 per share (without taking into account any adjustments as described below under "Changes in the Dividends-Received Percentage"). We will pay dividends on the Preferred Stock to the Holders on the relevant record date fixed by the Board of Directors, or a duly authorized committee thereof, which may not be earlier than 45 days or later than 10 days prior to the applicable Dividend Payment Date. If declared, the initial dividend, which will be for the period from and including April 6, 2001 to but excluding June 30, 2001, will be \$.6778 per share and, thereafter, if declared, quarterly dividends will be \$.7263 per share. After the initial dividend, the dividend period relating to a Dividend Payment Date will be the period from and including the preceding Dividend Payment Date to but excluding the Dividend Payment Date. If a Dividend Payment Date is not a Business Day, we will pay dividends (if declared) on the Preferred Stock on the succeeding Business Day, without interest from that Dividend Payment Date to the date of actual payment. A "Business Day" is any day other than a Saturday, Sunday, or other day on which banking institutions in New York, New York are authorized or required by law to close. We will compute dividends payable on the Preferred Stock for any period greater or less than a full dividend period on the basis of a 360-day year consisting of twelve 30-day months. The amount of dividends per share payable at redemption will be rounded to the fourth digit after the decimal point. (If the fifth digit to the right of the decimal point is five or greater, the fourth digit will be rounded up by one.)

The Preferred Stock will rank prior to the common stock of Fannie Mae with respect to the payment of dividends to the extent provided in the Certificate of Designation. As a result, unless dividends have been declared and paid or set apart (or ordered to be set apart) on the Preferred Stock for the then current quarterly dividend period, no dividend may be declared or paid or set apart for payment on Fannie Mae's common stock (or on any other stock of Fannie Mae ranking, as to the payment of dividends, junior to the Preferred Stock), other than dividends or distributions paid in shares of, or options, warrants or rights to subscribe for or purchase shares of, the common stock of Fannie Mae or any other stock of Fannie Mae ranking junior to the Preferred Stock as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae. When dividends are not paid in full upon the Preferred Stock and all other classes or series of stock of Fannie Mae, if any, ranking on a parity as to the payment of dividends with the Preferred Stock, all dividends declared upon shares of Preferred Stock and all such other stock of Fannie Mae will be declared pro rata so that the amount of dividends declared per share on the Preferred Stock and all such other stock will in all cases bear to each other the same ratio that accrued dividends per share on the shares of Preferred Stock (including any adjustment in the amount of dividends payable due to changes in the Dividends-Received Percentage (as defined below) but without, in the case of any non-cumulative preferred stock, accumulation of unpaid dividends for prior dividend periods) and each other stock bear to each other.

Dividends on the Preferred Stock will not be cumulative. If we do not pay a dividend on the Preferred Stock, the Holders of Preferred Stock will have no claim in respect of such non-payment so long as no dividend (other than those referred to in the preceding paragraph) is paid on Fannie Mae's common stock (or any other stock of Fannie Mae ranking, as to the payment of dividends, junior to the Preferred Stock) for the then-current quarterly dividend period.

The Board of Directors, or a duly authorized committee thereof, may, in its discretion, choose to pay dividends on the Preferred Stock without the payment of any dividends on Fannie Mae's common stock (or any other stock of Fannie Mae ranking, as to the payment of dividends, junior to the Preferred Stock).

No dividends may be declared or paid or set apart for payment on any shares of the Preferred Stock if at the same time any arrears exist or default exists in the payment of dividends on any outstanding class or series of stock of Fannie Mae ranking prior to the Preferred Stock with respect to the payment of dividends. At the time of issuance of the Preferred Stock, there will be no class or series of stock of Fannie Mae which ranks prior to the Preferred Stock with respect to the payment of dividends.

Holder of Preferred Stock will not be entitled to any dividends, whether payable in cash or property, other than as described above and will not be entitled to interest, or any sum in lieu of interest, in respect of any dividend payment.

See also "Regulatory Matters" for a description of certain regulatory restrictions on Fannie Mae's payment of dividends.

Changes in the Dividends-Received Percentage. If, prior to October 6, 2002, one or more amendments to the Internal Revenue Code of 1986, as amended (the "Code"), are enacted that eliminate or reduce the percentage of the dividends-received deduction applicable to the Preferred Stock (currently 70 percent) as specified in section 243(a)(1) of the Code or any successor provision (the "Dividends-Received Percentage"), certain adjustments may be made in respect of the dividends payable by Fannie Mae, and Post Declaration Date Dividends and Retroactive Dividends (as such terms are defined below) may become payable, as described below.

The amount of each dividend payable (if declared) per share of Preferred Stock for dividend payments made on or after the effective date of such change in the Code will be adjusted by multiplying the amount of the dividend that would otherwise be payable (before adjustment) by a factor, which will be the number determined in accordance with the following formula (the "DRD Formula"), and rounding the result to the nearest cent (with one-half cent rounded up):

$$\frac{1-.35(1-.70)}{1-.35(1-DRP)}$$

For purposes of the DRD Formula, "DRP" means the Dividends-Received Percentage (expressed as a decimal) applicable to the dividend in question; *provided, however*, that if the Dividends-Received Percentage applicable to the dividend in question shall be less than 50%, then the DRP shall equal .50. No amendment to the Code, other than a change in the percentage of the dividends-received deduction applicable to the Preferred Stock as set forth in section 243 (a)(1) of the Code or any successor provision, will give rise to an adjustment. Notwithstanding the foregoing provisions, if, with respect to any such amendment, Fannie Mae receives either an unqualified opinion of nationally recognized independent tax counsel selected by Fannie Mae or a private letter ruling or similar form of assurance from the Internal Revenue Service (the "IRS") to the effect that such an amendment does not apply to a dividend payable on the Preferred Stock, then such amendment will not result in the adjustment provided for pursuant to the DRD Formula with respect to such dividend. The opinion referenced in the previous sentence shall be based upon the legislation amending or establishing the DRP or upon a published pronouncement of the IRS addressing such legislation. Unless the context otherwise requires, references to dividends in this Offering Circular will mean dividends as adjusted by the DRD

Formula. Fannie Mae's calculation of the dividends payable as so adjusted shall be final and not subject to review.

Notwithstanding the foregoing, if any such amendment to the Code is enacted after the dividend payable on a Dividend Payment Date has been declared but before such dividend is paid, the amount of the dividend payable on such Dividend Payment Date will not be increased; instead, additional dividends (the "Post Declaration Date Dividends"), equal to the excess, if any, of (1) the product of the dividend paid by Fannie Mae on such Dividend Payment Date and the DRD Formula (where the DRP used in the DRD Formula would be equal to the greater of the Dividends-Received Percentage applicable to the dividend in question and .50) over (2) the dividend paid by Fannie Mae on such Dividend Payment Date, will be payable (if declared) to Holders of Preferred Stock on the record date applicable to the next succeeding Dividend Payment Date.

If any such amendment to the Code is enacted and the reduction in the Dividends-Received Percentage retroactively applies to a Dividend Payment Date as to which Fannie Mae previously paid dividends on the Preferred Stock (each, an "Affected Dividend Payment Date"), Fannie Mae will pay (if declared) additional dividends (the "Retroactive Dividends") to Holders of Preferred Stock on the record date applicable to the next succeeding Dividend Payment Date (or, if such amendment is enacted after the dividend payable on such Dividend Payment Date has been declared, to Holders of Preferred Stock on the record date applicable to the second succeeding Dividend Payment Date following the date of enactment), in an amount equal to the excess of (1) the product of the dividend paid by Fannie Mae on each Affected Dividend Payment Date and the DRD Formula (where the DRP used in the DRD Formula would be equal to the greater of the Dividends-Received Percentage and .50 applied to each Affected Dividend Payment Date) over (2) the sum of the dividend paid by Fannie Mae on each Affected Dividend Payment Date. Fannie Mae will only make one payment of Retroactive Dividends for any such amendment. Notwithstanding the foregoing provisions, if, with respect to any such amendment, Fannie Mae receives either an unqualified opinion of nationally recognized independent tax counsel selected by Fannie Mae or a private letter ruling or similar form of assurance from the IRS to the effect that such amendment does not apply to a dividend payable on an Affected Dividend Payment Date for the Preferred Stock, then such amendment will not result in the payment of Retroactive Dividends with respect to such Affected Dividend Payment Date. The opinion referenced in the previous sentence shall be based upon the legislation amending or establishing the DRP or upon a published pronouncement of the IRS addressing such legislation.

Notwithstanding the foregoing, Fannie Mae will not make any adjustment in the dividends payable by Fannie Mae, and Fannie Mae will not be required to pay Post Declaration Date Dividends or Retroactive Dividends, in respect of the enactment on or after October 6, 2002 of any amendment to the Code that eliminates or reduces the Dividends-Received Percentage.

In the event that the amount of dividends payable per share of the Preferred Stock is adjusted pursuant to the DRD Formula and/or Post Declaration Date Dividends or Retroactive Dividends are to be paid, Fannie Mae will give notice of each such adjustment and, if applicable, any Post Declaration Date Dividends and Retroactive Dividends to the Holders of Preferred Stock.

Optional Redemption

The Preferred Stock will not be redeemable prior to April 6, 2006. On or after that date, subject to the notice provisions set forth below and subject to any further limitations which may be imposed by law, Fannie Mae, at its option, may redeem the Preferred Stock, in whole or in part, at any time or from time to time, out of funds legally available therefor, at the redemption price of \$50 per share plus an amount equal to the dividend (whether or not declared) for the then-current quarterly dividend period accrued to but excluding the date of redemption, including any adjustments in dividends payable due to changes in the Dividends-Received Percentage but without accumulation of unpaid dividends on the Preferred Stock for prior dividend periods. If less than all of the outstanding shares of the Preferred Stock are to be redeemed, Fannie Mae will select shares to be redeemed from

the outstanding shares not previously called for redemption by lot or pro rata (as nearly as possible) or by any other method that the Board of Directors, or a duly authorized committee thereof, in its sole discretion deems equitable.

Fannie Mae will give notice of any such redemption by mail to Holders of Preferred Stock not less than 30 days prior to the date fixed by the Board of Directors, or duly authorized committee thereof, for such redemption. Each notice will state the number of shares of Preferred Stock to be redeemed and, if fewer than all of the shares of Preferred Stock held by the applicable Holder are to be redeemed, the number of shares to be redeemed from such Holder, the redemption price, the redemption date and the place at which such Holder's certificate(s) representing shares of the Preferred Stock must be presented upon such redemption.

Under certain circumstances, Fannie Mae may need the approval of the Director prior to exercising its right to redeem shares of Preferred Stock. See "Regulatory Matters."

Once proper notice has been given, from and after the redemption date, dividends on the Preferred Stock called for redemption will cease to accrue and such Preferred Stock called for redemption will no longer be deemed outstanding, and all rights of the Holders thereof as registered holders of the Preferred Stock will cease.

Liquidation Rights

Upon any voluntary or involuntary dissolution, liquidation or winding up of Fannie Mae, after payment or provision for the liabilities of Fannie Mae and the expenses of such dissolution, liquidation or winding up, the Holders of the outstanding shares of the Preferred Stock will be entitled to receive the amount of \$50 per share plus an amount equal to the dividend (whether or not declared) for the then-current quarterly dividend period accrued to but excluding the date of such liquidation payment, including any adjustments in dividends payable due to changes in the Dividends-Received Percentage but without accumulation of unpaid dividends on the Preferred Stock for prior dividend periods, out of the assets of Fannie Mae or proceeds thereof available for distribution to stockholders, before any payment or distribution of assets is made to holders of Fannie Mae's common stock (or any other stock of Fannie Mae ranking, as to the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, junior to the Preferred Stock). If the assets of Fannie Mae available for distribution in such event are insufficient to pay in full the aggregate amount payable to Holders of the Preferred Stock and holders of all other classes or series of stock of Fannie Mae, if any, ranking, as to the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, equally with the Preferred Stock, the assets will be distributed to the Holders of Preferred Stock and holders of such other stock pro rata, based on the full respective preferential amounts to which they are entitled (including any adjustments in dividends payable due to changes in the Dividends-Received Percentage but without, in the case of any noncumulative preferred stock, accumulation of unpaid dividends for prior dividend periods). After payment of the full amount of the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae to which they are entitled, the Holders of Preferred Stock will not be entitled to any further participation in any distribution of assets by Fannie Mae.

Notwithstanding the foregoing, Holders of Preferred Stock will not be entitled to be paid any amount in respect of a dissolution, liquidation or winding up of Fannie Mae until holders of any class or series of stock of Fannie Mae ranking, as to the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, prior to the Preferred Stock have been paid all amounts to which such classes or series are entitled. At the time of issuance of the Preferred Stock, there will be no class or series of stock of Fannie Mae ranking prior to the Preferred Stock with respect to the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae.

Neither the sale, lease or exchange (for cash, shares of stock, securities or other consideration) of all or substantially all of the property and assets of Fannie Mae, nor the merger, consolidation or combination of Fannie Mae into or with any other corporation, nor the merger, consolidation or

combination of any other corporation or entity into or with Fannie Mae, shall be deemed to be a dissolution, liquidation or winding up, voluntary or involuntary, for the purposes of these provisions on liquidation rights.

Regulatory Matters

Holders of Preferred Stock are entitled to receive cash dividends if, as and when declared by the Board of Directors, or a duly authorized committee thereof. However, certain provisions of the 1992 Act may operate to restrict the ability of the Board of Directors to declare dividends in certain circumstances. The 1992 Act established risk-based capital, minimum capital and critical capital requirements for Fannie Mae. OFHEO has released proposed risk-based capital regulations for public review and comment. Until one year after the final regulations establishing the risk-based capital test are in effect, a dividend may be paid without the prior approval of the Director of OFHEO if Fannie Mae meets the minimum capital level and the dividend payment would not decrease Fannie Mae's base capital below such level. See "Government Regulation and Charter Act."

One year after final regulations establishing the risk-based capital test take effect, a dividend may be paid without the prior approval of the Director if Fannie Mae meets both the risk-based capital and minimum capital levels and the dividend payment would not decrease Fannie Mae's total capital below the risk-based capital level or its core capital below the minimum capital level. If Fannie Mae meets either the risk-based capital standard or the minimum capital standard, it may make a dividend payment without obtaining the approval of the Director only if the dividend payment would not cause Fannie Mae to fail to meet another capital standard. At any time when Fannie Mae does not meet the risk-based capital standard but meets the minimum capital standard, Fannie Mae is prohibited from making a dividend payment that would cause Fannie Mae to fail to meet the minimum capital standard. If Fannie Mae meets neither the risk-based capital standard nor the minimum capital standard but does meet the critical capital standard established under the 1992 Act, it may make a dividend payment only if Fannie Mae would not fail to meet the critical capital standard as a result of such payment and the Director approves the payment after finding that it satisfies certain statutory conditions. The Director has the authority to require Fannie Mae to submit a report to the Director regarding any capital distribution (including any dividend) declared by Fannie Mae before Fannie Mae makes the distribution. See "Government Regulation and Charter Act" and "Management's Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Regulatory Environment" in the Information Statement regarding the capital standards applicable to Fannie Mae.

Voting Rights; Amendments

Except as provided below, the Holders of Preferred Stock will not be entitled to any voting rights.

Without the consent of the Holders of Preferred Stock, we may amend, alter, supplement, or repeal any terms of the Preferred Stock:

- to cure any ambiguity, or to cure, correct or supplement any provision contained in the Certificate of Designation that may be defective or inconsistent; or
- to make any other provision with respect to matters or questions arising with respect to the Preferred Stock that is not inconsistent with the provisions of the Certificate of Designation, so long as such action does not materially and adversely affect the interests of the Holders of Preferred Stock.

The following are deemed not to materially and adversely affect the interests of the Holders of Preferred Stock:

- any increase in the amount of authorized or issued Preferred Stock; or
- the creation and issuance, or an increase in the authorized or issued amount, of any other class or series of stock of Fannie Mae, whether ranking prior to, on a parity with or junior to the Preferred Stock as to dividends or liquidation or otherwise.

Otherwise, the terms of the Preferred Stock may be amended, altered, supplemented, or repealed only with the consent of the Holders of at least two-thirds of the outstanding shares of Preferred Stock. On matters requiring their consent, Holders of Preferred Stock will be entitled to one vote per share.

New York Stock Exchange Listing

We will apply to list the Preferred Stock on the NYSE under the symbol “FNMprH”. If approved for listing, we expect trading of the Preferred Stock on the NYSE to commence within a thirty-day period after the initial delivery of the Preferred Stock.

LEGALITY OF INVESTMENT

National banks may purchase, hold, and invest in for their own accounts the shares of Preferred Stock without regard to limitations generally applicable to investment securities. The Preferred Stock would be subject to a 100% risk weighting for capital adequacy purposes.

Federal savings associations and federal savings banks may invest in the shares of Preferred Stock without regard to limitations generally applicable to investments. Preferred Stock held by a federal savings association or federal savings bank would be subject to a 100% risk weighting for capital adequacy purposes.

Federally insured state-chartered banks, state-chartered savings banks, and state-chartered savings and loan associations may invest in the shares of Preferred Stock to the extent permitted by the Secondary Mortgage Market Enhancement Act of 1984 (“SMMEA”) and by applicable state law, after complying with any procedures imposed by the state. Preferred Stock held by such an institution would be subject to a 100% risk weighting for federal capital adequacy purposes.

Federal credit unions may purchase the shares of Preferred Stock without regard to limitations generally applicable to investments.

The shares of Preferred Stock are “stock . . . of a corporation which is an instrumentality of the United States” within the meaning of § 7701(a)(19)(C)(ii) of the Code for purposes of the 60 percent of assets limitation applicable to domestic building and loan associations.

In addition to the specific authorizations discussed above, § 106(a)(1) of SMMEA provides that any person, trust, corporation, partnership, association, business trust or business entity created pursuant to or existing under the laws of the United States or any state (including the District of Columbia and Puerto Rico) (an “investor”) is authorized to purchase, hold and invest in securities issued or guaranteed by Fannie Mae (including the shares of Preferred Stock) to the same extent that such investor is authorized to purchase, hold or invest in obligations issued or guaranteed as to principal and interest by the United States or any agency or instrumentality thereof. Prior to October 4, 1991, states were authorized by SMMEA to enact legislation that either prohibited or limited an investor’s authority to purchase, hold or invest in securities issued or guaranteed by Fannie Mae. To the best of our knowledge, 18 states currently have legislation limiting to varying extents the ability of certain entities (in most cases, insurance companies) to invest in securities issued or guaranteed by Fannie Mae, including the shares of Preferred Stock.

Notwithstanding the above, investors should consult their legal advisors to determine whether and to what extent the shares of Preferred Stock constitute legal investments for such investors or are eligible to be used as security for borrowings. The foregoing does not take into consideration the application of statutes, regulations, orders, guidelines or agreements generally governing investments made by a particular investor, including but not limited to “prudent investor” provisions, safety and soundness conditions and percentage-of-assets limits. The regulatory authorities that administer the legal provisions referred to above generally reserve discretion whether securities, such as the Preferred Stock, that are otherwise acceptable for investment may be purchased or pledged by the institutions subject to their jurisdiction. An institution under the jurisdiction of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the National Credit Union Administration, or any other federal or state agency with similar authority should review any applicable regulations, policy statements and guidelines before purchasing the Preferred Stock.

UNITED STATES TAXATION

The Preferred Stock and payments thereon generally are subject to taxation. Therefore, you should consider the tax consequences of owning Preferred Stock before acquiring it.

In the opinion of Arnold & Porter, our special tax counsel, the following discussion correctly describes the principal aspects of the U.S. federal income tax treatment of U.S. Persons (as defined below) that are beneficial holders of the Preferred Stock (“Shareholders”). This discussion does not address the U.S. federal income tax treatment of Shareholders that are not U.S. Persons. This discussion is based on the Internal Revenue Code of 1986, as amended (the “Code”), its legislative history, existing and proposed Treasury regulations, revenue rulings and judicial decisions, changes to any of which subsequent to the date of this Offering Circular may affect, possibly on a retroactive basis, the tax consequences described herein.

This summary discusses only the Preferred Stock purchased in this offering and held as a capital asset (within the meaning of federal tax law). This discussion does not purport to address all of the U.S. federal income tax consequences that may be applicable to particular investors in light of their individual circumstances or to Shareholders subject to special rules, such as dealers in securities, tax-exempt organizations, life insurance companies, persons liable for alternative minimum tax, persons that hold the Preferred Stock as part of a straddle or a hedging or conversion transaction, certain financial institutions and certain securities traders. In addition, this discussion does not address taxes imposed by any state, local or foreign taxing jurisdiction. In all cases, investors are advised to consult their own tax advisors regarding the U.S. federal tax consequences to them of holding, owning and disposing of Preferred Stock, as well as any tax consequences arising under the laws of any state or other taxing jurisdiction.

For purposes of this discussion, “U.S. Person” generally means (1) a citizen or individual resident of the United States, (2) a corporation or partnership created or organized in or under the laws of the United States or any political subdivision thereof, (3) an estate the income of which is includible in its gross income for U.S. federal income tax purposes without regard to its source, or (4) a trust if a court within the United States is able to exercise primary supervision over its administration and at least one U.S. Person has the authority to control all substantial decisions of the trust.

Dividends

Dividends declared and paid on the Preferred Stock will be dividends for U.S. federal income tax purposes to the extent paid out of our current or accumulated earnings and profits, as determined for federal income tax purposes, and will be taxable as ordinary income. Although we expect that our current and accumulated earnings and profits will be such that all dividends paid with respect to the Preferred Stock will qualify as dividends for federal income tax purposes, we cannot guarantee that

result. Our accumulated earnings and profits and our current earnings and profits in future years will depend in significant part on our future profits or losses, which we cannot accurately predict. To the extent that the amount of any dividend paid on a share of Preferred Stock exceeds our current or accumulated earnings and profits for federal income tax purposes attributable to that share, the dividend will be treated first as a return of capital (rather than as ordinary income) and will be applied against and reduce the Shareholder's adjusted tax basis in that share of Preferred Stock. The amount of any such dividend in excess of the Shareholder's adjusted tax basis will then be taxed as capital gain. For purposes of the remainder of this discussion, it is assumed that dividends paid with respect to the Preferred Stock will constitute dividends for U.S. federal income tax purposes.

Dividends received by Shareholders that are corporations generally will be eligible for the 70-percent dividends-received deduction under section 243 of the Code. The 70-percent dividends-received deduction will not be available with respect to a dividend received on Preferred Stock that a Shareholder has held for 45 days or less (including the day of disposition, but excluding the day of acquisition) during the 90-day period beginning on the day which is 45 days before the date on which the Preferred Stock becomes ex-dividend. If the dividend is attributable to a period or periods aggregating more than 366 days, the dividends-received deduction will be available only if the Shareholder has held the Preferred Stock for more than 90 days (including the day of disposition, but excluding the day of acquisition) during the 180-day period beginning 90 days before the date on which the Preferred Stock becomes ex-dividend. The length of time that a corporate shareholder is deemed to have held stock for these purposes is reduced by periods during which the shareholder's risk of loss with respect to the stock is diminished by reason of the existence of certain options, contracts to sell, short sales or other similar transactions. The aggregate dividends-received deduction allowed a corporate shareholder cannot exceed 70 percent of its taxable income (with certain adjustments). Moreover, the dividends-received deduction may be reduced if the stock is "debt financed." Stock is "debt financed" if a corporate shareholder incurs indebtedness "directly attributable" to a "portfolio stock" investment in another company, which would include an investment in the Preferred Stock.

Dispositions, Including Redemptions

Any sale, exchange, redemption (except as discussed below) or other disposition of the Preferred Stock generally will result in taxable gain or loss equal to the difference between the amount realized upon the disposition and the Shareholder's adjusted tax basis in the Preferred Stock. Such gain or loss will be capital gain or loss and will be long-term capital gain or loss if the holding period for the Preferred Stock exceeds one year. Tax rates on capital gain for individual Shareholders vary depending on each Shareholder's income and holding period for the Preferred Stock. Shareholders that are individuals should contact their own tax advisors for more information or for the capital gains tax rate applicable to specific shares of Preferred Stock. The deduction of capital losses is subject to certain limitations.

A redemption of Preferred Stock may be treated as a dividend, rather than as payment in exchange for the Preferred Stock, unless the redemption is "not essentially equivalent to a dividend" with respect to the Shareholder within the meaning of section 302(b)(1) of the Code, "is in complete redemption of all of the stock" of Fannie Mae held by the Shareholder as described in section 302(b)(3) of the Code or otherwise meets the requirements of one of the other exceptions from dividend treatment provided in section 302(b) of the Code. In applying these rules, the Shareholder must take into account not only the Preferred Stock and other stock of Fannie Mae that it owns directly, but also the Preferred Stock and other stock in Fannie Mae that it constructively owns within the meaning of section 318 of the Code. Because of the complex nature of these rules, each Shareholder should consult its tax advisor to determine whether a redemption of Preferred Stock will be treated as a dividend or as payment in exchange for the Preferred Stock. If the redemption payment is treated as a dividend, the rules discussed above under "Dividends" apply.

Information Reporting and Backup Withholding

Payments of dividends on shares of Preferred Stock and payments of proceeds upon the sale or redemption of Preferred Stock generally are required to be reported to the IRS except in the case of a beneficial holder that is an “exempt recipient.” Individuals generally are not exempt recipients, whereas corporations and certain other entities generally are exempt recipients.

Backup withholding of U.S. federal income tax at a rate of 31 percent may apply to payments made with respect to shares of Preferred Stock, as well as to payments of proceeds from the sale of shares of Preferred Stock, to Shareholders that are not exempt recipients and that fail to provide certain identifying information (such as the taxpayer identification number of the Shareholder) in the manner required.

The U.S. federal income tax discussion set forth above is included for general information only and may not be applicable depending upon a Shareholder’s particular situation. Each Shareholder should consult its own tax advisor with respect to the tax consequences to it of the ownership and disposition of the Preferred Stock, including the tax consequences under the tax laws of the United States, states, localities, countries other than the United States and any other taxing jurisdiction and the possible effects of changes in such tax laws.

UNDERWRITING

Subject to the terms and conditions set forth in the underwriting agreement (the “Underwriting Agreement”), Fannie Mae has agreed to sell to each of the Underwriters named below, and each of the Underwriters, for whom Bear, Stearns & Co. Inc. and Lehman Brothers Inc. (the “Representatives”) are acting as representatives, has severally agreed to purchase, the number of shares of Preferred Stock set forth opposite its name below:

<u>Underwriter</u>	<u>Number of Shares</u>
Bear, Stearns & Co. Inc.	3,200,000
Lehman Brothers Inc.	2,400,000
First Tennessee Bank National Association	800,000
Merrill Lynch, Pierce, Fenner & Smith Incorporated	800,000
Ormes Capital Markets, Inc.....	<u>800,000</u>
Total.....	<u>8,000,000</u>

In the Underwriting Agreement, the Underwriters have severally agreed, subject to the terms and conditions set forth therein, to purchase all the Preferred Stock offered hereby if any is purchased.

The Representatives have advised Fannie Mae that the Underwriters propose initially to offer the Preferred Stock to the public at the initial public offering price set forth on the cover page of this Offering Circular, and to certain dealers at such price less a concession not in excess of \$0.2625 per share. The Underwriters may allow, and such dealers may reallow, a discount not in excess of \$0.25 per share on sales to certain other dealers. After the initial public offering, the public offering price, concession and discount may be changed.

Prior to this offering, there has been no public market for the Preferred Stock. We will apply to list the Preferred Stock on the New York Stock Exchange under the symbol “FNMprH.” If accepted for listing, we expect that trading of the Preferred Stock on the New York Stock Exchange will commence within a thirty-day period after the initial delivery of the Preferred Stock. The Representatives have advised Fannie Mae that they intend to make a market in the Preferred Stock prior to the commencement of trading on the New York Stock Exchange, but are not obligated to do so and may discontinue any such market making at any time without notice.

In the Underwriting Agreement, Fannie Mae and the Underwriters have agreed to indemnify each other against and contribute toward certain liabilities.

The Underwriters and certain affiliates thereof engage in transactions with and perform services for Fannie Mae in the ordinary course of business.

The Underwriters may engage in certain transactions that stabilize the price of the Preferred Stock. These transactions may include entering stabilizing bids, which means the placing of a bid or the effecting of a purchase for the purpose of pegging, fixing or maintaining the price of the Preferred Stock. Neither we nor the Underwriters make any representation or prediction as to the direction or magnitude of any effect that the transactions described above may have on the price of the Preferred Stock. The Underwriters are not required to engage in any of these transactions. When so doing, the Underwriters act on their own behalf and not as our representatives. Any such transactions, if commenced, may be discontinued at any time.

RATING

Standard & Poor’s Ratings Group, a Division of the McGraw-Hill Companies, has assigned the Preferred Stock a rating of “AA–” and Moody’s Investors Service, Inc. has assigned a rating of “aa3.” A security rating is not a recommendation to buy, sell or hold securities and may be subject to revision or may be withdrawn at any time by the assigning rating organization.

ACCOUNTANTS

The financial statements of Fannie Mae as of December 31, 2000 and for each of the years in the three-year period ended December 31, 2000, included in Appendix B and incorporated herein by reference, have been included in reliance upon the report of KPMG LLP, independent certified public accountants, and upon the authority of that firm as experts in accounting and auditing.

VALIDITY OF THE PREFERRED STOCK

The validity of the Preferred Stock will be passed upon for Fannie Mae by O’Melveny & Myers LLP, New York, New York, and for the Underwriters by Sullivan & Cromwell, Washington, D.C. Certain U.S. federal income tax matters will be passed upon for Fannie Mae by Arnold & Porter, Washington, D.C.

ADDITIONAL INFORMATION ABOUT FANNIE MAE

This Offering Circular should be read only in conjunction with our Information Statement dated March 30, 2001 (the “Information Statement”), which is included in this Offering Circular as Appendix B and incorporated herein by this reference. This Offering Circular, together with the Information Statement and any other documents incorporated herein by reference, are referred to as the “Offering Circular.” Any Information Statement, supplement to it, or proxy statement published by us subsequent to the date of this Offering Circular and prior to the termination of the offering of the Preferred Stock shall be deemed to be incorporated herein by this reference. You should rely only

on the information provided or incorporated by reference in this Offering Circular, and you should rely only on the most current information.

You can obtain copies of any or all documents incorporated in this Offering Circular by reference without charge from the Office of Investor Relations, Fannie Mae, 3900 Wisconsin Avenue, N.W., Washington, D.C. 20016 (telephone: (202) 752-7115) or by accessing our World Wide Web site at www.fanniemae.com/investors. Except for the documents incorporated herein by reference, information on our World Wide Web site does not constitute part of this Offering Circular. In addition, copies of such documents can be obtained from any of the Underwriters. You can read the Information Statement, proxy statements and other information concerning us at the offices of the New York Stock Exchange, the Chicago Stock Exchange, and the Pacific Exchange.

**CERTIFICATE OF DESIGNATION OF TERMS OF
5.81% NON-CUMULATIVE PREFERRED STOCK, SERIES H**

1. Designation, Par Value and Number of Shares.

The designation of the series of preferred stock of the Federal National Mortgage Association (“Fannie Mae”) created by this resolution shall be “5.81% Non-Cumulative Preferred Stock, Series H” (the “Series H Preferred Stock”), and the number of shares initially constituting the Series H Preferred Stock is Eight Million (8,000,000). Shares of Series H Preferred Stock will have no par value and a stated value and liquidation preference of \$50 per share. The Board of Directors of Fannie Mae, or a duly authorized committee thereof, in its sole discretion, may reduce the number of shares of Series H Preferred Stock, provided such reduction is not below the number of shares of Series H Preferred Stock then outstanding.

2. Dividends.

(a) Holders of record of Series H Preferred Stock (each individually a “Holder”, or collectively the “Holders”) will be entitled to receive, when, as and if declared by the Board of Directors of Fannie Mae, or a duly authorized committee thereof, in its sole discretion out of funds legally available therefor, non-cumulative quarterly cash dividends which will accrue from and including April 6, 2001 and will be payable on March 31, June 30, September 30 and December 31 of each year (each, a “Dividend Payment Date”), commencing June 30, 2001 at the annual rate of \$2.9052 per share or 5.81% of the stated value and liquidation preference of \$50 per share (without taking into account any adjustments referred to in clause (b) below). If a Dividend Payment Date is not a Business Day, the related dividend (if declared) will be paid on the next succeeding Business Day with the same force and effect as though paid on the Dividend Payment Date, without any increase to account for the period from such Dividend Payment Date through the date of actual payment. A “Business Day” shall mean any day other than a Saturday, Sunday, or a day on which banking institutions in New York, New York are authorized by law to close. Dividends will be paid to Holders on the record date fixed by the Board of Directors or a duly authorized committee thereof, which may not be earlier than 45 days or later than 10 days prior to the applicable Dividend Payment Date. If declared, the initial dividend, which will be for the period from and including April 6, 2001 to but excluding June 30, 2001, will be \$0.6778 per share and will be payable on June 30, 2001 and, thereafter, if declared, quarterly dividends will be \$0.7263 per share. After the initial dividend, the dividend period relating to a Dividend Payment Date will be the period from and including the preceding Dividend Payment Date to but excluding the related Dividend Payment Date. If Fannie Mae redeems the Series H Preferred Stock, the dividend that would otherwise be payable for the then-current quarterly dividend period accrued to but excluding the date of redemption will be included in the redemption price of the shares redeemed and will not be separately payable. Dividends payable on the Series H Preferred Stock for any period greater or less than a full dividend period will be computed on the basis of a 360-day year consisting of twelve 30-day months. The amount of dividends per share payable at redemption will be rounded to the fourth digit after the decimal point. (If the fifth digit to the right of the decimal point is five or greater, the fourth digit will be rounded up by one.)

(b) If, prior to October 6, 2002, one or more amendments to the Internal Revenue Code of 1986, as amended (the “Code”), are enacted that eliminate or reduce the percentage of the dividends-received deduction applicable to the Series H Preferred Stock as specified in section 243(a)(1) of the Code or any successor provision thereto (the “Dividends-Received Percentage”), certain adjustments may be made in respect of the dividends payable by Fannie Mae, and Post Declaration Date Dividends and Retroactive Dividends (as such terms are defined below) may become payable, as described below.

The amount of each dividend payable (if declared) per share of Series H Preferred Stock for dividend payments made on or after the effective date of such change in the Code will be adjusted by

multiplying the amount of the dividend payable pursuant to clause (a) of this Section 2 (before adjustment) by a factor, which will be the number determined in accordance with the following formula (the “DRD Formula”), and rounding the result to the nearest cent (with one-half cent rounded up):

$$\frac{1-.35(1-.70)}{1-.35(1-DRP)}$$

For purposes of the DRD Formula, “DRP” means the Dividends-Received Percentage (expressed as a decimal) applicable to the dividend in question; provided, however, that if the Dividends-Received Percentage applicable to the dividend in question shall be less than 50%, then the DRP shall equal .50. No amendment to the Code, other than a change in the percentage of the dividends-received deduction applicable to the Series H Preferred Stock as set forth in section 243(a)(1) of the Code or any successor provision thereto, will give rise to an adjustment. Notwithstanding the foregoing provisions, if, with respect to any such amendment, Fannie Mae receives either an unqualified opinion of nationally recognized independent tax counsel selected by Fannie Mae or a private letter ruling or similar form of assurance from the Internal Revenue Service (the “IRS”) to the effect that such an amendment does not apply to a dividend payable on the Series H Preferred Stock, then such amendment will not result in the adjustment provided for pursuant to the DRD Formula with respect to such dividend. The opinion referenced in the previous sentence shall be based upon the legislation amending or establishing the DRP or upon a published pronouncement of the IRS addressing such legislation. Unless the context otherwise requires, references to dividends herein will mean dividends as adjusted by the DRD Formula. Fannie Mae’s calculation of the dividends payable as so adjusted shall be final and not subject to review.

Notwithstanding the foregoing, if any such amendment to the Code is enacted after the dividend payable on a Dividend Payment Date has been declared but before such dividend is paid, the amount of the dividend payable on such Dividend Payment Date will not be increased; instead, additional dividends (the “Post Declaration Date Dividends”), equal to the excess, if any, of (1) the product of the dividend paid by Fannie Mae on such Dividend Payment Date and the DRD Formula (where the DRP used in the DRD Formula would be equal to the greater of the Dividends-Received Percentage applicable to the dividend in question and .50) over (2) the dividend paid by Fannie Mae on such Dividend Payment Date, will be payable (if declared) to Holders on the record date applicable to the next succeeding Dividend Payment Date.

If any such amendment to the Code is enacted and the reduction in the Dividends-Received Percentage retroactively applies to a Dividend Payment Date as to which Fannie Mae previously paid dividends on the Series H Preferred Stock (each, an “Affected Dividend Payment Date”), Fannie Mae will pay (if declared) additional dividends (the “Retroactive Dividends”) to Holders on the record date applicable to the next succeeding Dividend Payment Date (or, if such amendment is enacted after the dividend payable on such Dividend Payment Date has been declared, to Holders on the record date applicable to the second succeeding Dividend Payment Date following the date of enactment), in an amount equal to the excess of (1) the product of the dividend paid by Fannie Mae on each Affected Dividend Payment Date and the DRD Formula (where the DRP used in the DRD Formula would be equal to the greater of the Dividends-Received Percentage and .50 applied to each Affected Dividend Payment Date) over (2) the sum of the dividend paid by Fannie Mae on each Affected Dividend Payment Date. Fannie Mae will only make one payment of Retroactive Dividends for any such amendment. Notwithstanding the foregoing provisions, if, with respect to any such amendment, Fannie Mae receives either an unqualified opinion of nationally recognized independent tax counsel selected by Fannie Mae or a private letter ruling or similar form of assurance from the IRS

to the effect that such amendment does not apply to a dividend payable on an Affected Dividend Payment Date for the Series H Preferred Stock, then such amendment will not result in the payment of Retroactive Dividends with respect to such Affected Dividend Payment Date. The opinion referenced in the previous sentence shall be based upon legislation amending or establishing the DRP or upon a published pronouncement of the IRS addressing such legislation.

Notwithstanding the foregoing, no adjustment in the dividends payable by Fannie Mae shall be made, and no Post Declaration Date Dividends or Retroactive Dividends shall be payable by Fannie Mae, in respect of the enactment of any amendment to the Code on or after October 6, 2002 that eliminates or reduces the Dividends-Received Percentage.

In the event that the amount of dividends payable per share of Series H Preferred Stock is adjusted pursuant to the DRD Formula and/or Post Declaration Date Dividends or Retroactive Dividends are to be paid, Fannie Mae will cause notice of each such adjustment and, if applicable, Post Declaration Date Dividends and Retroactive Dividends to be given as soon as practicable to the Holders of Series H Preferred Stock.

(c) No dividend (other than dividends or distributions paid in shares of, or options, warrants or rights to subscribe for or purchase shares of, the common stock of Fannie Mae or any other stock of Fannie Mae ranking, as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, junior to the Series H Preferred Stock) may be declared or paid or set apart for payment on Fannie Mae's common stock (or on any other stock of Fannie Mae ranking, as to the payment of dividends, junior to the Series H Preferred Stock) unless dividends have been declared and paid or set apart (or ordered to be set apart) on the Series H Preferred Stock for the then-current quarterly dividend period; provided, however, that the foregoing dividend preference shall not be cumulative and shall not in any way create any claim or right in favor of the Holders of Series H Preferred Stock in the event that dividends have not been declared or paid or set apart (or ordered to be set apart) on the Series H Preferred Stock in respect of any prior dividend period. If the full dividend on the Series H Preferred Stock is not paid for any quarterly dividend period, the Holders of Series H Preferred Stock will have no claim in respect of the unpaid amount so long as no dividend (other than those referred to above) is paid on Fannie Mae's common stock (or any other stock of Fannie Mae ranking, as to the payment of dividends, junior to the Series H Preferred Stock) for such dividend period.

(d) The Board of Directors of Fannie Mae, or a duly authorized committee thereof, may, in its discretion, choose to pay dividends on the Series H Preferred Stock without the payment of any dividends on Fannie Mae's common stock (or any other stock of Fannie Mae ranking, as to the payment of dividends, junior to the Series H Preferred Stock).

(e) No full dividends shall be declared or paid or set apart for payment on any stock of Fannie Mae ranking, as to the payment of dividends, on a parity with the Series H Preferred Stock for any period unless full dividends have been declared and paid or set apart for payment on the Series H Preferred Stock for the then-current quarterly dividend period. When dividends are not paid in full upon the Series H Preferred Stock and all other classes or series of stock of Fannie Mae, if any, ranking, as to the payment of dividends, on a parity with the Series H Preferred Stock, all dividends declared upon shares of Series H Preferred Stock and all such other stock of Fannie Mae will be declared pro rata so that the amount of dividends declared per share of Series H Preferred Stock and all such other stock will in all cases bear to each other the same ratio that accrued dividends per share of Series H Preferred Stock (including any adjustments in dividends payable due to changes in the Dividends-Received Percentage but without, in the case of any noncumulative preferred stock, accumulation of unpaid dividends for prior dividend periods) and such other stock bear to each other.

(f) No dividends may be declared or paid or set apart for payment on any shares of Series H Preferred Stock if at the same time any arrears exist or default exists in the payment of dividends on any outstanding class or series of stock of Fannie Mae ranking, as to the payment of dividends, prior to the Series H Preferred Stock.

(g) Holders of Series H Preferred Stock will not be entitled to any dividends, whether payable in cash or property, other than as herein provided and will not be entitled to interest, or any sum in lieu of interest, in respect of any dividend payment.

3. Optional Redemption.

(a) The Series H Preferred Stock shall not be redeemable prior to April 6, 2006. On or after that date, subject to the notice provisions set forth in Section 3(b) below and subject to any further limitations which may be imposed by law, Fannie Mae may redeem the Series H Preferred Stock, in whole or in part, at any time or from time to time, out of funds legally available therefor, at the redemption price of \$50 per share plus an amount equal to the amount of the dividend (whether or not declared) for the then-current quarterly dividend period accrued to but excluding the date of such redemption, including any adjustments in dividends payable due to changes in the Dividends-Received Percentage but without accumulation of unpaid dividends on the Series H Preferred Stock for prior dividend periods. If less than all of the outstanding shares of Series H Preferred Stock are to be redeemed, Fannie Mae will select the shares to be redeemed from the outstanding shares not previously called for redemption by lot or pro rata (as nearly as possible) or by any other method that the Board of Directors of Fannie Mae, or a duly authorized committee thereof, in its sole discretion deems equitable.

(b) In the event Fannie Mae shall redeem any or all of the Series H Preferred Stock as aforesaid, Fannie Mae will give notice of any such redemption to Holders of Series H Preferred Stock not less than 30 days prior to the date fixed by the Board of Directors of Fannie Mae, or duly authorized committee thereof, for such redemption. Each such notice will state: (1) the number of shares of Series H Preferred Stock to be redeemed and, if fewer than all of the shares of Series H Preferred Stock held by a Holder are to be redeemed, the number of shares to be redeemed from such Holder; (2) the redemption price; (3) the redemption date; and (4) the place at which a Holder's certificate(s) representing shares of Series H Preferred Stock must be presented upon such redemption. Failure to give notice, or any defect in the notice, to any Holder of Series H Preferred Stock shall not affect the validity of the proceedings for the redemption of shares of any other Holder of Series H Preferred Stock being redeemed.

(c) Notice having been given as herein provided, from and after the redemption date, dividends on the Series H Preferred Stock called for redemption shall cease to accrue and such Series H Preferred Stock called for redemption will no longer be deemed outstanding, and all rights of the Holders thereof as registered holders of such shares of Series H Preferred Stock will cease. Upon surrender in accordance with said notice of the certificate(s) representing shares of Series H Preferred Stock so redeemed (properly endorsed or assigned for transfer, if the Board of Directors of Fannie Mae, or a duly authorized committee thereof, shall so require and the notice shall so state), such shares shall be redeemed by Fannie Mae at the redemption price aforesaid. Any shares of Series H Preferred Stock that shall at any time have been redeemed shall, after such redemption, be cancelled and not reissued. In case fewer than all the shares represented by any such certificate are redeemed, a new certificate shall be issued representing the unredeemed shares without cost to the Holder thereof.

(d) The Series H Preferred Stock will not be subject to any mandatory redemption, sinking fund or other similar provisions. In addition, Holders of Series H Preferred Stock will have no right to require redemption of any shares of Series H Preferred Stock.

4. Liquidation Rights.

(a) Upon any voluntary or involuntary dissolution, liquidation or winding up of Fannie Mae, after payment or provision for the liabilities of Fannie Mae and the expenses of such dissolution, liquidation or winding up, the Holders of outstanding shares of the Series H Preferred Stock will be entitled to receive out of the assets of Fannie Mae or proceeds thereof available for distribution to stockholders, before any payment or distribution of assets is made to holders of Fannie Mae's common stock (or any other stock of Fannie Mae ranking, as to the distribution of assets upon dissolution,

liquidation or winding up of Fannie Mae, junior to the Series H Preferred Stock), the amount of \$50 per share plus an amount equal to the dividend (whether or not declared) for the then-current quarterly dividend period accrued to but excluding the date of such liquidation payment, including any adjustments in dividends payable due to changes in the Dividends-Received Percentage but without accumulation of unpaid dividends on the Series H Preferred Stock for prior dividend periods.

(b) If the assets of Fannie Mae available for distribution in such event are insufficient to pay in full the aggregate amount payable to Holders of Series H Preferred Stock and holders of all other classes or series of stock of Fannie Mae, if any, ranking, as to the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, on a parity with the Series H Preferred Stock, the assets will be distributed to the Holders of Series H Preferred Stock and holders of all such other stock pro rata, based on the full respective preferential amounts to which they are entitled (including any adjustments in dividends payable due to changes in the Dividends-Received Percentage but without, in the case of any noncumulative preferred stock, accumulation of unpaid dividends for prior dividend periods).

(c) Notwithstanding the foregoing, Holders of Series H Preferred Stock will not be entitled to be paid any amount in respect of a dissolution, liquidation or winding up of Fannie Mae until holders of any classes or series of stock of Fannie Mae ranking, as to the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, prior to the Series H Preferred Stock have been paid all amounts to which such classes or series are entitled.

(d) Neither the sale, lease or exchange (for cash, shares of stock, securities or other consideration) of all or substantially all of the property and assets of Fannie Mae, nor the merger, consolidation or combination of Fannie Mae into or with any other corporation or the merger, consolidation or combination of any other corporation or entity into or with Fannie Mae, shall be deemed to be a dissolution, liquidation or winding up, voluntary or involuntary, for the purposes of this Section 4.

(e) After payment of the full amount of the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae to which they are entitled pursuant to paragraphs (a), (b) and (c) of this Section 4, the Holders of Series H Preferred Stock will not be entitled to any further participation in any distribution of assets by Fannie Mae.

5. No Conversion Or Exchange Rights.

The Holders of shares of Series H Preferred Stock will not have any rights to convert such shares into or exchange such shares for shares of any other class or classes, or of any other series of any class or classes, of stock or obligations of Fannie Mae.

6. No Pre-Emptive Rights.

No Holder of Series H Preferred Stock shall be entitled as a matter of right to subscribe for or purchase, or have any pre-emptive right with respect to, any part of any new or additional issue of stock of any class whatsoever, or of securities convertible into any stock of any class whatsoever, or any other shares, rights, options or other securities of any class whatsoever, whether now or hereafter authorized and whether issued for cash or other consideration or by way of dividend.

7. Voting Rights; Amendments.

(a) Except as provided below, the Holders of Series H Preferred Stock will not be entitled to any voting rights, either general or special.

(b) Without the consent of the Holders of Series H Preferred Stock, Fannie Mae will have the right to amend, alter, supplement or repeal any terms of this Certificate or the Series H Preferred Stock (1) to cure any ambiguity, or to cure, correct or supplement any provision contained in this Certificate of Designation that may be defective or inconsistent with any other provision herein or (2) to make any other provision with respect to matters or questions arising with respect to the Series H Preferred Stock that is not inconsistent with the provisions of this Certificate of Designation so long as such action does not materially and adversely affect the interests of the Holders of Series H

Preferred Stock; provided, however, that any increase in the amount of authorized or issued Series H Preferred Stock or the creation and issuance, or an increase in the authorized or issued amount, of any other class or series of stock of Fannie Mae, whether ranking prior to, on a parity with or junior to the Series H Preferred Stock, as to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, or otherwise, will not be deemed to materially and adversely affect the interests of the Holders of Series H Preferred Stock.

(c) Except as set forth in paragraph (b) of this Section 7, the terms of this Certificate or the Series H Preferred Stock may be amended, altered, supplemented, or repealed only with the consent of the Holders of at least two-thirds of the shares of Series H Preferred Stock then outstanding, given in person or by proxy, either in writing or at a meeting of stockholders at which the Holders of Series H Preferred Stock shall vote separately as a class. On matters requiring their consent, Holders of Series H Preferred Stock will be entitled to one vote per share.

(d) The rules and procedures for calling and conducting any meeting of Holders (including, without limitation, the fixing of a record date in connection therewith), the solicitation and use of proxies at such a meeting, the obtaining of written consents, and any other aspect or matter with regard to such a meeting or such consents shall be governed by any rules that the Board of Directors of Fannie Mae, or a duly authorized committee thereof, in its discretion, may adopt from time to time, which rules and procedures shall conform to the requirements of any national securities exchange on which the Series H Preferred Stock are listed at the time.

8. Additional Classes or Series of Stock.

The Board of Directors of Fannie Mae, or a duly authorized committee thereof, shall have the right at any time in the future to authorize, create and issue, by resolution or resolutions, one or more additional classes or series of stock of Fannie Mae, and to determine and fix the distinguishing characteristics and the relative rights, preferences, privileges and other terms of the shares thereof. Any such class or series of stock may rank prior to, on a parity with or junior to the Series H Preferred Stock as to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, or otherwise.

9. Priority.

For purposes of this Certificate of Designation, any stock of any class or series of Fannie Mae shall be deemed to rank:

(a) Prior to the shares of Series H Preferred Stock, either as to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, if the holders of such class or series shall be entitled to the receipt of dividends or of amounts distributable upon dissolution, liquidation or winding up of Fannie Mae, as the case may be, in preference or priority to the Holders of shares of Series H Preferred Stock.

(b) On a parity with shares of Series H Preferred Stock, either as to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, whether or not the dividend rates or amounts, dividend payment dates or redemption or liquidation prices per share, if any, be different from those of the Series H Preferred Stock, if the holders of such class or series shall be entitled to the receipt of dividends or of amounts distributable upon dissolution, liquidation or winding up of Fannie Mae, as the case may be, in proportion to their respective dividend rates or amounts or liquidation prices, without preference or priority, one over the other, as between the holders of such class or series and the Holders of shares of Series H Preferred Stock.

(c) Junior to shares of Series H Preferred Stock, either as to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae, if such class shall be common stock of Fannie Mae or if the Holders of shares of Series H Preferred Stock shall be entitled to the receipt of dividends or of amounts distributable upon dissolution, liquidation or winding up of Fannie Mae, as the case may be, in preference or priority over the holders of such class or series.

(d) The shares of Preferred Stock of Fannie Mae designated “6.50% Non-Cumulative Preferred Stock, Series B” (the “Series B Preferred Stock”), “6.45% Non-Cumulative Preferred Stock, Series C” (the “Series C Preferred Stock”), “5.25% Non-Cumulative Preferred Stock, Series D” (the “Series D Preferred Stock”), “5.10% Non-Cumulative Preferred Stock, Series E” (the “Series E Preferred Stock”), “Variable Rate Non-Cumulative Preferred Stock, Series F” (the “Series F Preferred Stock”) and “Variable Rate Non-Cumulative Preferred Stock, Series G” (the “Series G Preferred Stock”) shall be deemed to rank on a parity with shares of Series H Preferred Stock as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of Fannie Mae. Accordingly, the holders of record of Series B Preferred Stock, the holders of record of Series C Preferred Stock, the holders of record of Series D Preferred Stock, the holders of record of Series E Preferred Stock, the holders of record of Series F Preferred Stock, the holders of record of Series G Preferred Stock and the Holders of Series H Preferred Stock shall be entitled to the receipt of dividends and of amounts distributable upon dissolution, liquidation or winding up of Fannie Mae, as the case may be, in proportion to their respective dividend rates or amounts or liquidation prices, without preference or priority, one over the other.

10. Transfer Agent, Dividend Disbursing Agent and Registrar.

Fannie Mae hereby appoints First Chicago Trust Company a division of EquiServe as its initial transfer agent, dividend disbursing agent and registrar for the Series H Preferred Stock. Fannie Mae may at any time designate an additional or substitute transfer agent, dividend disbursing agent and registrar for the Series H Preferred Stock.

11. Notices.

Any notice provided or permitted by this Certificate of Designation to be made upon, or given or furnished to, the Holders of Series H Preferred Stock by Fannie Mae shall be made by first-class mail, postage prepaid, to the addresses of such Holders as they appear on the books and records of Fannie Mae. Such notice shall be deemed to have been sufficiently made upon deposit thereof in the United States mail. Notwithstanding anything to the contrary contained herein, in the case of the suspension of regular mail service or by reason of any other cause it shall be impracticable, in Fannie Mae’s judgment, to give notice by mail, then such notification may be made, in Fannie Mae’s discretion, by publication in a newspaper of general circulation in The City of New York or by hand delivery to the addresses of Holders as they appear on the books and records of Fannie Mae.

Receipt and acceptance of a share or shares of the Series H Preferred Stock by or on behalf of a Holder shall constitute the unconditional acceptance by such Holder (and all others having beneficial ownership of such share or shares) of all of the terms and provisions of this Certificate of Designation. No signature or other further manifestation of assent to the terms and provisions of this Certificate of Designation shall be necessary for its operation or effect as between Fannie Mae and the Holder (and all such others).

APPENDIX B

INFORMATION STATEMENT DATED MARCH 30, 2001

Information Statement



This Information Statement describes the business and operations of the Federal National Mortgage Association (“Fannie Mae”) as of March 30, 2001 and its financial condition as of December 31, 2000. It contains Fannie Mae’s audited financial statements for the year ended December 31, 2000.

In connection with offerings of securities, Fannie Mae distributes offering circulars, prospectuses, or other offering documents that describe securities offered, their selling arrangements and other information. Although typically incorporated by reference into such selling documents, the Information Statement does not offer any securities for sale. Any incorporation of this Information Statement by reference includes all supplements hereto. You may obtain copies of the current Information Statement, any supplements, and other available information from Fannie Mae as provided under “Available Information” on page 2. Fannie Mae updates its Information Statement quarterly.

Fannie Mae is a federally chartered corporation. Its principal office is located at 3900 Wisconsin Avenue, NW, Washington, DC 20016 (202/752-7000). Its Internal Revenue Service employer identification number is 52-0883107.

Fannie Mae’s securities are not required to be registered under the Securities Act of 1933. At the close of business on February 28, 2001, approximately 1,000 million shares of Fannie Mae’s common stock (without par value) were outstanding.

The delivery of this Information Statement shall not at any time under any circumstances create an implication that there has been no change in the affairs of Fannie Mae since the date hereof or that the information contained herein is correct as of any time subsequent to its date.

March 30, 2001

TABLE OF CONTENTS

<u>Caption</u>	<u>Page</u>
Documents Incorporated by Reference	2
Available Information	2
Business	3
General	3
Mortgage Loan Portfolio	3
Mortgage-Backed Securities	7
Affordable Housing Initiatives	8
Housing Goals	8
Delinquencies and REO	9
Fee-Based Services	9
Competition	9
Facilities	10
Employees	11
Government Regulation and Charter Act	11
Recent Developments	14
Interest Rate Risk	14
Credit Risk	15
Risk-Based Capital Stress Test	15
Legal Proceedings	16
Common and Preferred Stock	16
Forward-Looking Information	18
Selected Financial Information: 1996-2000	20
Management’s Discussion and Analysis of Financial Condition and Results of Operations ...	21
Index to Financial Statements	49
Management	85

DOCUMENTS INCORPORATED BY REFERENCE

Fannie Mae’s Proxy Statement for the May 2001 Annual Meeting of Shareholders is incorporated by reference herein under “Management—Additional Information.” Prior to the date of the Proxy Statement for the May 2001 Annual Meeting of Shareholders, the Proxy Statement for the May 2000 Annual Meeting of Shareholders is incorporated herein by this reference. Fannie Mae will supplement this Information Statement to reflect its quarterly financial results and other events and information as Fannie Mae determines. References to the “Information Statement” include any documents incorporated herein by reference and any applicable amendments or supplements. If Fannie Mae modifies or updates information in the Information Statement in a later supplement or in a document incorporated by reference in this Information Statement, the information as modified or updated replaces the information initially reported by Fannie Mae in this Information Statement.

AVAILABLE INFORMATION

Fannie Mae periodically makes available statistical information on its mortgage purchase and mortgage-backed securities volumes as well as other relevant information about Fannie Mae. You may obtain copies of this Information Statement and any supplements, as well as Fannie Mae’s annual reports to stockholders, proxy statement, quarterly financial releases, the Federal National Mortgage Association Charter Act, Fannie Mae’s bylaws and other information regarding Fannie Mae without charge from the Office of Investor Relations, Fannie Mae, 3900 Wisconsin Avenue, NW, Washington, DC 20016 (telephone: (202/752-7115)). This Information Statement and supplements to it are also available by accessing Fannie Mae’s Web site at <http://www.fanniemae.com/investors>. You may inspect reports and other information concerning Fannie Mae at the offices of the New York Stock Exchange, the Chicago Stock Exchange, and the Pacific Exchange. Fannie Mae does not file reports or other information with the Securities and Exchange Commission.

BUSINESS

General

Fannie Mae is a federally chartered, stockholder-owned corporation, and the largest investor in home mortgage loans in the United States. Fannie Mae was established in 1938 as a United States government agency to provide supplemental liquidity to the mortgage market. It became a stockholder-owned and privately managed corporation by legislation enacted in 1968.

Fannie Mae provides funds to the mortgage market by purchasing mortgage loans from lenders, thereby replenishing their funds for additional lending. Fannie Mae acquires funds to purchase these loans by issuing debt securities to capital market investors, many of whom ordinarily would not invest in mortgages. In this manner, Fannie Mae is able to expand the total amount of funds available for housing.

Fannie Mae also issues Mortgage-Backed Securities (“MBS”), receiving guaranty fees for its guarantee of timely payment of principal and interest on MBS certificates. Fannie Mae issues MBS primarily in exchange for pools of mortgage loans from lenders. The issuance of MBS enables Fannie Mae to further its statutory purpose of increasing the liquidity of residential mortgage loans.

In addition, Fannie Mae offers various services to lenders and others for a fee. These services include issuing certain types of MBS and credit enhancements and providing technology services for originating and underwriting loans. For information regarding Fannie Mae’s mortgage loan, MBS, and other activities in 2000, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

In this document, both whole loans and participation interests in loans are referred to as “loans,” “mortgage loans” and “mortgages.” (Fannie Mae purchases participation interests that range from 50 to 99 percent.) The term “mortgage” also is used to refer to the deed of trust or other security instrument securing a loan rather than the loan itself. Mortgage loans secured by four or fewer dwelling units are referred to as “single-family” mortgage loans and mortgage loans secured by more than four dwelling units are referred to as “multifamily” mortgage loans.

Mortgage Loan Portfolio

Mortgage Loans Purchased

Fannie Mae purchases primarily single-family, conventional (*i.e.*, not federally insured or guaranteed), fixed- or adjustable-rate, first mortgage loans. It also purchases other types of residential mortgage loans for its portfolio, including mortgage loans insured by the Federal Housing Administration (“FHA”), mortgage loans guaranteed by the Department of Veterans Affairs (“VA”) or the Rural Housing Service, multifamily mortgage loans and subordinate mortgage loans (*i.e.*, loans secured by second liens, etc.). Fannie Mae’s purchases have a variety of maturities and are designed to provide a secondary market for a variety of loans that may be attractive to homeowners. Fannie Mae’s mortgage loan purchases for its portfolio include purchases of mortgage-backed securities.

The composition of Fannie Mae’s loan portfolio at the end of each of the last five years is shown in the table under “Portfolio Composition.” The composition of its purchases during the last three years is shown in Table 10 of “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Mortgage Portfolio.” Approximately 81 percent of the mortgage loans and mortgage-backed securities that Fannie Mae purchased in 2000 (measured by unpaid principal balance (“UPB”)) were from investment banking companies, 6 percent were from mortgage banking companies, 5 percent were from savings and loan associations, 2 percent were from commercial and mutual savings banks, and 6 percent were from other institutions.

Principal Balance Limits. Maximum principal balance limits apply to Fannie Mae’s mortgage loan purchases. For 2000, Fannie Mae could not purchase conventional mortgage loans on

single-family dwellings if the loan's original principal balance exceeded \$252,700, except for loans secured by properties in Alaska, Hawaii and the Virgin Islands. Higher principal balance limits apply to loans secured by properties in those areas or secured by two- to four-family dwelling units. The maximum principal balance limits applicable to conventional mortgage loans secured by one- to four-family dwellings can be adjusted by Fannie Mae annually based on the national average price of a single-family dwelling as surveyed by the Federal Housing Finance Board. In January 2001, the maximum principal balance limit was increased to \$275,000.

Mortgage loans insured by the FHA or guaranteed by the Rural Housing Service are subject to statutory maximum amount limitations. Fannie Mae will not purchase VA-guaranteed mortgage loans in excess of principal amounts that Fannie Mae specifies from time to time. There are no statutory limits on the maximum principal balance of multifamily mortgage loans that Fannie Mae purchases; however, most purchases are within limits established by Fannie Mae based on per unit dollar amounts set forth in the National Housing Act.

Maturity/Balloon Payments. Fannie Mae currently purchases conventional, single-family fixed- and adjustable-rate mortgages ("ARMs") with original maturities of up to 30 years and 40 years, respectively. Only a small portion of ARMs purchased have maturities of more than 30 years. The multifamily mortgage loans that Fannie Mae currently purchases for its portfolio generally are conventional fixed-rate loans that have maturities of up to 30 years.

Substantially all fixed-rate mortgage loans purchased by Fannie Mae provide for level monthly installments of principal and interest. Some of these loans have balloon payments due 5, 7 or 10 years after origination, but with monthly payments based on longer (e.g. 30-year) amortization schedules. Most of the 7-year balloon single-family mortgage loans permit the borrower to refinance the balloon payment at maturity with a 23-year fixed-rate mortgage loan if certain requirements are satisfied. Many of the multifamily mortgage loans have balloon payments due 5, 7, 10 or 15 years after origination, but with payments based on 25- or 30-year amortization schedules.

Adjustable Rate. The interest rates on ARMs are determined by formulas providing for automatic adjustment, up or down, at specified intervals in accordance with changes in specified indices. Fixed-period ARMs have a stable interest rate for the first three to ten years, which then is adjusted at specified intervals thereafter. Substantially all ARMs provide for monthly installments of principal and/or interest with the total amount of monthly installments adjusted (up or down) after the interest rate on the loan is adjusted because of changes in the applicable index. Fannie Mae currently purchases single-family ARMs only if the ARMs have a cap on the amount the interest rate may change over the life of the loan. A substantial number of the ARMs purchased provide the borrower with the option, at specified times or during specified periods of time, to convert the ARM to a fixed-rate mortgage loan with the payment of a small fee.

Fannie Mae also purchases certain ARMs, called reverse mortgages, that provide for monthly installments of principal to be paid to the borrower. Over the life of the loan, interest and certain other fees accrue on the balance of the payments made to the borrower. Fannie Mae currently purchases reverse mortgages only if the reverse mortgages are subject to a cap on the amount the interest rate may change over the life of the loan. Generally, the loan is due when the borrower no longer occupies the property.

Prepayments

Substantially all of the single-family mortgage loans in Fannie Mae's portfolio are prepayable by the borrower without penalty. Therefore, Fannie Mae bears the risk that prepayments may increase when interest rates decline significantly or as a result of other factors. Fannie Mae manages this risk as described in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Risk Management—Interest Rate Risk Management." Most multifamily loans in Fannie Mae's portfolio provide for defeasance of the loan or require a prepayment premium that is

calculated under a formula intended to protect Fannie Mae from loss of yield on its investment if the mortgage loan is prepaid.

Portfolio Composition

The following table shows the composition of Fannie Mae's mortgage loan portfolio and the weighted-average yield (net of servicing) on the mortgage loan portfolio. The table includes mortgage loans that back MBS held in Fannie Mae's mortgage loan portfolio.

Mortgage Loan Portfolio Composition

	December 31,				
	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>
	(Dollars in millions)				
Single-family:					
Government insured or guaranteed	\$ 44,166	\$ 41,029	\$ 21,805	\$ 19,478	\$ 15,912
Conventional:					
Long-term, fixed-rate	454,349	385,321	297,106	211,541	177,070
Intermediate-term, fixed-rate	66,619	69,019	71,560	61,571	66,284
Adjustable-rate	27,135	14,107	11,873	11,373	12,783
Second	480	176	206	268	323
Multifamily	17,373	14,289	11,965	12,447	14,680
Total UPB	<u>\$610,122</u>	<u>\$523,941</u>	<u>\$414,515</u>	<u>\$316,678</u>	<u>\$287,052</u>
Yield	7.24%	7.08%	7.12%	7.60%	7.69%

Commitments

Fannie Mae issues commitments to purchase a specified dollar amount of mortgage loans during a specified term. Fannie Mae purchases mortgage loans through standard product commitments with posted yields and through negotiated commitments.

Most of the mortgage loans Fannie Mae purchases for its portfolio are acquired pursuant to mandatory delivery commitments. Under such commitments, lenders are obligated to sell loans to Fannie Mae at the commitment yield. Mandatory delivery commitments are available for standard product and negotiated transactions. If a lender is not able to deliver the mortgage loans required under a mandatory delivery commitment during its term, the lender may buy back the commitment at any time during the commitment term at a market price.

Fannie Mae issues master commitments to lenders to facilitate the delivery of mortgages into MBS pools or portfolio. In order to deliver under a master commitment, a lender must either deliver mortgages in exchange for MBS or enter into a mandatory delivery portfolio commitment with the yield established upon execution of the portfolio commitment.

Fannie Mae also issues to lenders negotiated standby commitments that commit Fannie Mae to purchase a designated dollar amount of single-family mortgage loans from the lenders if they convert their standby commitments to mandatory delivery portfolio commitments. Standby commitments do not obligate the lenders to sell the loans to Fannie Mae; they are obligated to do so only after such commitments are converted to mandatory delivery portfolio commitments. The yield on the mortgage loans is established at the time of conversion of the standby commitments. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Liquidity and Capital Resources."

Underwriting Guidelines

Fannie Mae has established certain underwriting guidelines for purchases of conventional mortgage loans to help reduce the risk of loss from borrower defaults. These guidelines are designed to assess the creditworthiness of the borrower, as well as the value of the mortgaged property relative to the amount of the mortgage loan. Fannie Mae, in its discretion, accepts waivers from the guidelines.

Fannie Mae also reviews and changes its guidelines from time to time. As part of its affordable housing initiatives, Fannie Mae continues to introduce new underwriting criteria that could make the mortgage finance system more accessible to minorities, low-and moderate-income families, underserved and rural residents and people with special housing needs. In addition, Fannie Mae is continuing its underwriting initiatives involving alternative methods of assessing the creditworthiness of potential borrowers, among other factors. See “Affordable Housing Initiatives.”

Fannie Mae generally relies on lender representations to ensure that the mortgage loans it purchases conform to its applicable underwriting guidelines. Fannie Mae also performs quality control reviews of selected loans to monitor compliance with the guidelines. In the event that a lender is found to have breached its representations with respect to a loan’s compliance with the guidelines, Fannie Mae can demand that the lender repurchase the loan or indemnify Fannie Mae against any loss.

Over the last several years, Fannie Mae has enhanced Desktop Underwriter®, its automated underwriting system, to assist lenders in meeting its underwriting standards. Desktop Underwriter is designed to help lenders process mortgage applications in a more efficient and accurate manner and to apply Fannie Mae’s underwriting criteria consistently, objectively, and in a more customized manner to all prospective borrowers. If Desktop Underwriter provides an “approve” recommendation to a loan application, Fannie Mae waives certain representations as long as the loan is originated in accordance with the information that was submitted to Desktop Underwriter.

Risk Sharing

Risk sharing through credit enhancement is an integral part of Fannie Mae’s credit risk management strategy. In addition, Fannie Mae’s charter requires that conventional single-family mortgage loans with a UPB in excess of 80 percent of the value of the mortgaged property be subject to one of three alternative credit enhancement structures in order to be eligible for purchase by Fannie Mae. Fannie Mae uses all three alternative structures. The most commonly used credit enhancement is primary mortgage insurance in at least the amount of the loan over the 80 percent level, provided by an insurance company acceptable to Fannie Mae. Fannie Mae also has obtained credit enhancement for a majority of the mortgage loans in its multifamily loan portfolio. In addition, Fannie Mae contracts for and manages credit enhancements at, or subsequent to, acquisition of loans to optimize credit risk management. Fannie Mae bears the risk that in some cases parties assuming credit enhancement obligations may be unable to meet their contractual obligations. Fannie Mae regularly monitors this risk and follows specific criteria in evaluating and accepting credit enhancement arrangements in order to minimize its exposure to credit loss. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Risk Management—Credit Risk Management.”

Servicing

Fannie Mae does not service mortgage loans, except for some government-insured multifamily loans or on an interim basis for loans after termination of a servicer that are serviced under a subservicing arrangement with a major servicing entity. Fannie Mae generally manages and markets properties acquired through foreclosure. Mortgage loans held in portfolio or backing MBS can be serviced only by a servicer approved by Fannie Mae, and they must be serviced subject to Fannie Mae’s guidelines. Lenders who sell single-family mortgage loans and conventional multifamily loans to Fannie Mae typically are approved servicers and initially service the mortgage loans they sell to Fannie Mae. Servicing includes the collection and remittance of principal and interest payments, administration of escrow accounts, evaluation of transfers of ownership interests, responding to requests for partial releases of security, handling proceeds from casualty losses, negotiating problem loan workouts and, if necessary, processing of foreclosures. In the case of multifamily loans, servicing also may include performing property inspections, evaluating the financial condition of owners, and administering various types of agreements (including agreements regarding replacement reserves, completion or repair, and operations and maintenance). Fannie Mae compensates servicers in a

number of ways, including in many cases permitting them to retain a specified portion of each interest payment on a serviced mortgage loan. Fannie Mae reserves the right to remove servicing responsibility from a lender.

Mortgage-Backed Securities

MBS are mortgage pass-through trust certificates issued and guaranteed by Fannie Mae that represent beneficial interests in pools of mortgage loans or other MBS. Fannie Mae serves as trustee for each trust.

MBS are backed by loans from one of three sources: a single lender, multiple lenders, or Fannie Mae's portfolio. Single-lender MBS generally are issued through lender swap transactions in which a lender exchanges pools of mortgage loans for MBS. Multiple-lender MBS allow several lenders to pool mortgage loans together and, in return, receive MBS representing a proportionate share of a larger pool (called Fannie Majors®). MBS may back other securities, including Fannie Megas® ("Megas"), Stripped MBS ("SMBS"), real estate mortgage investment conduit securities ("REMICs"), and other mortgage securities utilizing a "grantor trust" structure.

MBS are not assets of Fannie Mae, except when acquired for portfolio investment purposes, nor are MBS recorded as liabilities. Fannie Mae, however, is liable under its guarantee to make timely payments to investors of principal and interest on the MBS, even if Fannie Mae has not received payments of principal or interest on the mortgage loans in the underlying pools. MBS enable Fannie Mae to further its statutory purpose of increasing the liquidity of residential mortgage loans and create a source of guaranty fee income. Because Fannie Mae guarantees the timely payment of principal and interest, it assumes the ultimate credit risk of borrowers' defaults on mortgage loans underlying MBS. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Risk Management—Credit Risk Management."

Fannie Mae issues MBS backed by single-family or multifamily first or subordinate mortgage loans with fixed or adjustable rates. Generally, the mortgage loans are either conventional mortgage loans, or FHA-, VA- or Rural Housing Service-guaranteed mortgage loans. The conventional mortgage loans are subject to the maximum principal balance limits applicable to Fannie Mae's purchases as described under "Mortgage Loan Portfolio—Mortgage Loans Purchased—Principal Balance Limits." The mortgage loans also are subject to the underwriting guidelines applicable to Fannie Mae's purchases as described under "Mortgage Loan Portfolio—Underwriting Guidelines." The majority of Fannie Mae's MBS outstanding represents beneficial interests in conventional fixed-rate first mortgage loans on single-family dwellings.

Fannie Mae issues and guarantees several forms of MBS that involve only a single class of certificates (principally its standard MBS and Fannie Majors), with each investor receiving a portion of the payments of principal and interest on the underlying mortgage loans equal to its undivided interest in the pool. With these standard MBS, an investor has an undivided interest in a pool of underlying mortgage loans that generally are provided either by one lender or by Fannie Mae out of its mortgage loan portfolio. Megas represent undivided interests in a pool of MBS, REMIC tranches, or Government National Mortgage Association ("Ginnie Mae") guaranteed pass-through certificates ("Ginnie Mae certificates") of the same type. In addition, Fannie Mae issues and guarantees MBS in the form of single-class "grantor trust" securities representing an undivided interest in a pool of MBS, Ginnie Mae certificates, other mortgage-backed securities, or mortgage loans.

Fannie Mae also issues and guarantees other mortgage-backed securities that involve more than one class of certificates and, therefore, require special allocations of cash flows. SMBS are issued in series with one or more classes, each of which is entitled to different cash flows and may represent (1) an undivided interest solely in the principal payments, (2) an undivided interest solely in the interest payments, or (3) different percentage interests in principal and interest payments to be made on a pool of mortgage loans, MBS, REMICs, other SMBS and/or Ginnie Mae certificates. REMICs represent beneficial interests in a trust having multiple classes of certificates entitled to different cash

flows from the underlying mortgage loans, MBS, SMBS, Megas, Ginnie Mae certificates and/or certificates from other REMICs. Pursuant to the guaranty provided to REMICs and SMBS certificate holders, Fannie Mae is obligated to make timely distribution of required installments of principal and/or interest and, in the case of REMICs, to distribute the principal balance in full by a specified date, whether or not sufficient funds are available in the related REMIC trust. Fannie Mae has issued a limited amount of subordinated REMIC classes that are not guaranteed by Fannie Mae.

Fannie Mae receives guaranty fees for a significant portion of its MBS (principally its standard MBS and Fannie Majors). Such fees generally are paid monthly until the underlying mortgage loans have been repaid or otherwise liquidated from the pool (usually as a result of prepayment or delinquency). The aggregate amount of guaranty fees Fannie Mae receives depends upon the amount of MBS outstanding and on the guaranty fee rate. The amount of MBS outstanding is influenced by the rates at which the underlying mortgage loans are repaid or liquidated from the pool and by the rate at which Fannie Mae issues new MBS. In general, when the prevailing interest rates decline significantly below the interest rates on loans underlying MBS, the rate of single-family prepayments is likely to increase, as is the issuance of new MBS; conversely, when interest rates rise above the interest rates on loans underlying MBS, the rate of single-family prepayments and new MBS issuance is likely to slow down. In addition, the rate of principal prepayments is influenced by a variety of economic, demographic, and other factors. Fannie Mae also generally receives one-time fees for swapping SMBS, REMICs, Megas, grantor trust securities for MBS, mortgage loans, Ginnie Mae certificates, SMBS, REMIC certificates, or other mortgage-backed securities.

Fannie Mae typically does not service the loans in an MBS pool. Fannie Mae, however, reserves the right to remove the servicing responsibility from a lender at any time if it considers such removal to be in the best interest of MBS certificate holders. In such event, Fannie Mae finds a replacement lender that will service the loans. Generally, Fannie Mae ultimately is responsible to MBS holders for the administration and servicing of mortgage loans underlying MBS, including the collection and receipt of payments from lenders and the remittance of distributions and certain reports to holders of MBS certificates.

Affordable Housing Initiatives

In 2000, Fannie Mae met its “Trillion Dollar Commitment” to help finance over 10 million homes for families and communities most in need during the seven years from 1994 through 2000. On March 15, 2000, Fannie Mae announced its “American Dream CommitmentSM”—a pledge to invest \$2 trillion over the next ten years to help finance housing for 18 million home buyers and renters and join with housing partners to reverse decay in inner cities and older suburbs and expand the availability of livable, affordable rental housing. The new plan will focus on (i) promoting mortgage consumer rights, including broader, more equal access to lowest-cost mortgage credit; (ii) fighting mortgage discrimination and leading the housing market in serving minority families, including a pledge to provide \$420 billion in financing for 3 million minority households; (iii) addressing the unique housing needs of women-headed households, young families, new immigrants, seniors, and urban and rural dwellers; (iv) strengthening inner city and older suburban areas through new capital investments and expanded Partnership Offices; (v) providing new technologies to mortgage lenders and consumers in order to lower the costs of mortgage financing; and (vi) increasing the supply of affordable rental housing.

Housing Goals

Under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the “1992 Act”), Fannie Mae has certain goals to promote affordable housing for moderate-, low- and very low-income families and to serve the housing needs of those in underserved areas. In 2000, Fannie Mae exceeded the applicable goals. In October 2000 the Secretary of the U.S. Department of Housing and Urban Development (“HUD”) issued new housing goals for 2001 and thereafter. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Housing Goals.”

Delinquencies and REO

When a mortgage loan for which Fannie Mae bears the default risk is liquidated through foreclosure, Fannie Mae generally acquires the underlying property (such real estate owned is called “REO”) and holds it for sale. The level of delinquencies and number of REO are affected by economic conditions, loss mitigation efforts (which include contacting delinquent borrowers to offer a repayment plan, loan modification, preforeclosure sale, or other options), contractual provisions in credit enhancements, and a variety of other factors. Fannie Mae manages the risk of delinquencies and REO as described in “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Risk Management—Credit Risk Management.”

Fee-Based Services

Fannie Mae offers certain services to lenders and other customers in return for a fee. These include issuing REMICs, SMBS, Fannie Megas and grantor trust securities, providing technology services for originating and underwriting loans, and the facilitation of securities transactions. Fannie Mae receives fee income from dealers in exchange for creating and issuing REMICs, SMBS, grantor trust securities, and Megas. In addition to issuing these securities, Fannie Mae is responsible for all tax reporting and administration costs associated with these securities.

Fannie Mae also receives fee income in return for providing technology related services such as Desktop Underwriter, Desktop Originator®, Desktop Trader®, and other on-line services. These services provide lenders the ability to underwrite mortgage loans electronically, communicate with third-party originators, access Fannie Mae loan pricing schedules, and enter into sale commitments with Fannie Mae on a real-time basis.

Fannie Mae also simultaneously purchases and sells MBS and certain other mortgage-related securities, such as Ginnie Mae certificates, with the intention of earning a spread on such trades or as a service to customers. In addition, Fannie Mae receives fee income through other activities, such as repurchase transactions, and by providing credit enhancements and other investment alternatives for customers.

Competition

Fannie Mae competes, within the limits prescribed by its Charter Act, for the purchase of mortgage loans for portfolio and the issuance of mortgage-backed securities in the secondary mortgage market. For single-family products, Fannie Mae competes primarily with the Federal Home Loan Mortgage Corporation (“Freddie Mac”), another government-sponsored enterprise also regulated by HUD and the Office of Federal Housing Enterprise Oversight (“OFHEO”) with a mission and authority that is virtually identical to that of Fannie Mae. Fannie Mae competes to a lesser extent with savings and loan associations, savings banks, commercial banks, other government-sponsored entities, and other companies that purchase single-family mortgage loans for their own portfolio or pool single-family mortgage loans for sale to investors as whole loans or mortgage-backed securities. A number of Federal Home Loan Banks (“FHLBs”) began a program in 1997, as a “pilot” initiative, for the financing and servicing of single-family mortgage loans. The “pilot” was expanded in 1998 and 1999 and the volume cap was removed in 2000, making it a regular program. The pace of development of the program to date has not positioned the FHLBs as significant competitors, but the structure of the program presents the potential for significant competition in the future.

Fannie Mae competes with the FHA insurance program, a HUD program, for the business of guaranteeing the credit performance of mortgage loans and, due to the eligibility of such FHA-insured loans for securitization by Ginnie Mae, with Ginnie Mae as well. The fiscal year 1999 federal budget increased the base maximum principal balance for loans eligible for the FHA insurance program to 48 percent from 38 percent of Fannie Mae’s loan limits. The loan limit for FHA-insured loans in high cost areas was increased from 75 percent and now can be as high as 87 percent of Fannie Mae’s limits. The higher FHA limits may result in increased competition for Fannie Mae’s guaranty business. For

additional information on the maximum principal balances for loans purchased by Fannie Mae, see “Mortgage Loan Portfolio—Mortgage Loans Purchased—Principal Balance Limits.”

In the case of multifamily products, Fannie Mae generally competes with government housing programs, Freddie Mac, insurance companies, and the same kinds of entities it competes with in the single-family market. Competition for multifamily mortgage loans is intense from certain entities typically sponsored by investment banks that purchase such loans and pool them for sale to investors in the commercial mortgage-backed securities market. Such entities are referred to as “conduits,” and their role in the multifamily mortgage market has increased significantly over the last five years. Conduits continue to be a strong source of competition.

Competition is particularly intense for multifamily mortgage loans eligible for government subsidies, which have low-income rent and occupancy restrictions. As a prerequisite to expansion or merger plans, commercial banks must fund such loans to meet certain obligations under the Community Reinvestment Act, and they often are willing to do so at or below their own cost of funds. Fannie Mae competes for these same investment opportunities to meet its housing goals.

Fannie Mae competes primarily on the basis of price, products, structures, and services offered. Competition based on advances in technology-related and other fee-based services continues to increase, as do the types and nature of the products offered by Fannie Mae, Freddie Mac, and other market participants. Fannie Mae’s market share of loans purchased for cash or swapped for MBS is affected by the volume of mortgage loans offered for sale in the secondary market by loan originators and other market participants and the amount purchased by other market participants that compete with Fannie Mae.

Under the 1992 Act, the Secretary of HUD must approve any new Fannie Mae or Freddie Mac conventional mortgage program that is significantly different from those approved or engaged in prior to that Act’s enactment. The ability of Fannie Mae and Freddie Mac to compete with other competitors possibly could be affected by this requirement. See “Government Regulation and Charter Act.”

Competition also is a consideration in connection with the issuance of Fannie Mae’s debt securities. Fannie Mae competes with Freddie Mac, the FHLB system, the Student Loan Marketing Association, and other government-sponsored entities for funds raised through the issuance of unsecured debt in the “agency” debt market. Increases in the issuance of unsecured debt by other government-sponsored entities generally, and in the issuance of callable debt in particular, may have an adverse effect on the issuance of Fannie Mae’s unsecured debt or result in the issuance of such debt at higher interest rates than would otherwise be the case. In addition, the availability and cost of funds raised through the issuance of certain types of unsecured debt may be adversely affected by regulatory initiatives that tend to reduce investments by certain depository institutions in unsecured debt with greater than normal volatility or interest-rate sensitivity.

Facilities

Fannie Mae owns its principal office, which is located at 3900 Wisconsin Avenue, NW, Washington, DC, offices at 3939 Wisconsin Avenue, NW and 4250 Connecticut Avenue, NW, Washington, DC, and two facilities in Herndon, Virginia. These owned facilities total 802,000 square feet. In addition, Fannie Mae leases approximately 379,000 square feet of office space at 4000 Wisconsin Avenue, NW, which is adjacent to Fannie Mae’s principal office, and approximately 64,000 square feet of office space at 2115 Wisconsin Avenue, NW. The present lease for 4000 Wisconsin Avenue expires in 2003, but Fannie Mae has options to extend the lease for up to 15 additional years, in 5-year increments. The lease for 2115 Wisconsin Avenue expires in 2002. Fannie Mae also maintains regional offices in leased premises in Pasadena, California; Atlanta, Georgia; Chicago, Illinois; Philadelphia, Pennsylvania; and Dallas, Texas. The regional offices negotiate mortgage loan and MBS business with lenders, assist in supervising the servicing of Fannie Mae’s mortgage loan portfolio by lenders, assist in supervising or managing the handling and disposition of REO, and provide training to the staffs of lenders. In

addition to the regional offices, Fannie Mae has 48 “Fannie Mae Partnership Offices” in leased premises around the country which work with cities, rural areas and other underserved communities. Fannie Mae also plans to establish five additional Partnership Offices in 2001. There currently are Fannie Mae Partnership Offices in Birmingham, Alabama; Phoenix, Arizona; Los Angeles, California; San Francisco, California; Denver, Colorado; Hartford, Connecticut; Washington, D.C.; Miami, Florida; Orlando, Florida; Atlanta, Georgia; Chicago, Illinois; Indianapolis, Indiana; Des Moines, Iowa; Lexington, Kentucky; New Orleans, Louisiana; Baltimore, Maryland; Boston, Massachusetts; Detroit, Michigan; St. Paul, Minnesota; Jackson, Mississippi; Kansas City, Missouri; St. Louis, Missouri; Helena, Montana; Lincoln, Nebraska; Las Vegas, Nevada; Manchester, New Hampshire; Newark, New Jersey; Albuquerque, New Mexico; Buffalo, New York; New York, New York; Charlotte, North Carolina; Bismarck, North Dakota; Oklahoma City, Oklahoma; Cleveland, Ohio; Columbus, Ohio; Portland, Oregon; Pittsburgh, Pennsylvania; Columbia, South Carolina; Sioux Falls, South Dakota; Nashville, Tennessee; Houston, Texas; San Antonio, Texas (two offices, one of which is responsible for border region issues); Salt Lake City, Utah; Arlington, Virginia; Seattle, Washington; Milwaukee, Wisconsin; and Cheyenne, Wyoming.

Employees

At December 31, 2000, Fannie Mae employed approximately 4,100 full-time personnel.

GOVERNMENT REGULATION AND CHARTER ACT

Fannie Mae is a federally chartered and stockholder-owned corporation organized and existing under the Federal National Mortgage Association Charter Act, 12 U.S.C. § 1716 *et seq.* (the “Charter Act”) whose purpose is to (1) provide stability in the secondary market for residential mortgages, (2) respond appropriately to the private capital market, (3) provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing, and (4) promote access to mortgage credit throughout the nation (including central cities, rural areas and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing.

Fannie Mae originally was incorporated in 1938 pursuant to Title III of the National Housing Act as a wholly owned government corporation and in 1954, under a revised Title III called the Federal National Mortgage Association Charter Act, became a mixed-ownership corporate instrumentality of the United States. From 1950 to 1968, it operated in the Housing and Home Finance Agency, which was succeeded by HUD. Pursuant to amendments to the Charter Act enacted in the Housing and Urban Development Act of 1968 (the “1968 Act”), the then Federal National Mortgage Association was divided into two separate institutions, the present Fannie Mae and the Government National Mortgage Association, a wholly owned corporate instrumentality of the United States within HUD, which carried on certain special financing assistance and management and liquidation functions. Under the 1968 Act, Fannie Mae was constituted as a federally chartered corporation and the entire equity interest in Fannie Mae became stockholder-owned.

Although the 1968 Act eliminated all federal ownership interest in Fannie Mae, it did not terminate government regulation of Fannie Mae. Under the Charter Act, approval of the Secretary of the Treasury is required for Fannie Mae’s issuance of its debt obligations and MBS. In addition, the 1992 Act established OFHEO, an independent office within HUD under the management of a Director (the “Director”) who is responsible for ensuring that Fannie Mae is adequately capitalized and operating safely in accordance with the 1992 Act. The Director is authorized to levy, pursuant to annual Congressional appropriations, annual assessments on Fannie Mae and Freddie Mac to cover reasonable expenses of OFHEO. The 1992 Act established minimum capital, risk-based capital, and

critical capital requirements for Fannie Mae and required the Director to establish, by regulation, a risk-based capital test to be used to determine the amount of total capital Fannie Mae must hold to meet the risk-based capital standard on a quarterly basis. OFHEO issued a final rule (the “Rule”) in 1996 related to the minimum capital levels for Fannie Mae and Freddie Mac that sets forth how minimum capital requirements for both entities are to be calculated, reported, and classified on a quarterly basis. The Rule formalized the interim capital standards applied by OFHEO, with which Fannie Mae has been in compliance since their inception. See also “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Regulatory Environment.”

OFHEO has proposed regulations to establish the risk-based capital test for Fannie Mae and Freddie Mac in two parts. Part I specifies that “benchmark loss experience” will be combined with other yet to be determined assumptions and applied each quarter to Fannie Mae’s book of business to establish credit losses under the risk-based capital standard for Fannie Mae. Part I also specifies the house price index that OFHEO will use in connection with the risk-based capital standard. Fannie Mae submitted comments on Part I stating that several aspects of the initial proposal require adjustments or amendment, because it does not accurately capture Fannie Mae’s credit history and derives credit loss rates that are significantly worse than any reasonable representation of Fannie Mae’s and Freddie Mac’s loss experience. Part II specifies, among other matters, remaining aspects of the test and how the test will be used to determine Fannie Mae’s and Freddie Mac’s risk-based capital requirements. The summary accompanying Part II noted that if Part II had been in effect as of June 30, 1997, Fannie Mae’s required risk-based capital would have been \$17.73 billion, as compared with \$14.05 billion in actual capital at that time. OFHEO also noted that there were a variety of means, such as hedging, that Fannie Mae could have used to reduce required risk-based capital to the level of its actual capital. Fannie Mae submitted comments on Part II detailing three principal criteria that management used to evaluate Part II of the proposed regulations: operational workability, the ability to accommodate innovation, and linking of capital to risk. Management concluded that OFHEO’s proposed regulations failed to meet these three criteria and made suggestions for addressing these points. Management believes that the final risk-based standard could be modified substantially from its current proposed form. The 1992 Act provides that the final regulations will be enforceable one year after issuance. Management expects that Fannie Mae will be able to meet any reasonable final test.

If Fannie Mae fails to meet one or more of the capital standards under the 1992 Act, the Director is required to take certain remedial measures, and may take others, depending on the standards Fannie Mae fails to meet. The Director’s enforcement powers include the power to impose temporary and final cease-and-desist orders and civil penalties on Fannie Mae and on directors or executive officers of Fannie Mae. If the Director determines that Fannie Mae is engaging in conduct not approved by the Director that could result in a rapid depletion of core capital or that the value of the property subject to mortgages held or securitized by Fannie Mae has decreased significantly, the Director is authorized to treat Fannie Mae as not meeting one of the capital standards that it otherwise meets. In addition, Fannie Mae is required to submit a capital restoration plan if it fails to meet any of the capital standards. If the Director does not approve the plan or determines that Fannie Mae has failed to make reasonable efforts to comply with the plan, then the Director may treat Fannie Mae as not meeting one of the capital standards that it otherwise meets. Also, if Fannie Mae fails to meet or is treated by the Director as not meeting one of the capital standards and the Director has reasonable cause to believe that Fannie Mae or any executive officer or director of Fannie Mae is engaging in or about to engage in any conduct that threatens to result in a significant depletion of Fannie Mae’s core capital, then the Director is authorized to commence proceedings pursuant to which, after a hearing, the Director could issue a cease and desist order prohibiting such conduct. The Director could issue such an order without a hearing, which would be effective until completion of the cease-and-desist proceedings, if the Director determined that the conduct in question was likely to cause a significant depletion of core capital. Prior approval of the Director is required for Fannie Mae

to pay a dividend if the dividend would decrease Fannie Mae's capital below risk-based capital or minimum capital levels established under the 1992 Act. See "Common and Preferred Stock."

The 1992 Act gives the Director the authority to conduct on-site examinations of Fannie Mae for purposes of ensuring Fannie Mae's financial safety and soundness. The Charter Act, as amended by the 1992 Act, also authorizes the General Accounting Office to audit the programs, activities, receipts, expenditures, and financial transactions of Fannie Mae. Fannie Mae is required to submit annual and quarterly reports of the financial condition and operations of Fannie Mae to the Director. Fannie Mae also is required to submit an annual report to the House and Senate Banking Committees and the Secretary of HUD regarding Fannie Mae's performance in meeting housing goals established by the Secretary of HUD relating to the purchase of mortgages on housing for low- and moderate-income families, mortgages on rental and owner-occupied housing for low-income families in low-income areas or for very-low-income families, and mortgages on housing located in rural or other underserved areas. The Secretary of HUD has recently proposed new housing goals for Fannie Mae. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Housing Goals."

Under the 1992 Act, the Secretary of HUD retains general regulatory authority to promulgate rules and regulations to carry out the purposes of the Charter Act, excluding authority over matters granted exclusively to the Director of OFHEO in the 1992 Act. The Secretary of HUD also must approve any new conventional mortgage program that is significantly different from those approved or engaged in prior to the 1992 Act. The Secretary is required to approve any new program unless it is not authorized by the Charter Act of Fannie Mae or the Secretary finds that it is not in the public interest. However, until one year after the final regulations establishing the risk-based capital test are in effect, the Secretary must disapprove a new program if the Director determines that the program would risk significant deterioration of the financial condition of Fannie Mae. The Secretary has adopted regulations related to the program approval requirement.

Thirteen members of Fannie Mae's eighteen-member Board of Directors are elected by the holders of Fannie Mae's common stock, and the remaining five members are appointed by the President of the United States. The appointed directors must include one person from the home building industry, one person from the mortgage lending industry, and one person from the real estate industry. Under the 1992 Act, one appointed director also must be from an organization that has represented consumer or community interests for not less than two years or a person who has demonstrated a career commitment to the provision of housing for low-income households. Any member of the Board of Directors that is appointed by the President of the United States may be removed by the President for good cause.

In addition to placing Fannie Mae under federal regulation, the Charter Act also grants to Fannie Mae certain privileges. For instance, securities issued by Fannie Mae are deemed to be "exempt securities" under laws administered by the Securities and Exchange Commission ("SEC") to the same extent as securities that are obligations of, or guaranteed as to principal and interest by, the United States. Registration statements with respect to Fannie Mae's securities are not filed with the SEC. Fannie Mae also is not required to file periodic reports with the SEC.

The Secretary of the Treasury of the United States has discretionary authority to purchase obligations of Fannie Mae up to a maximum of \$2.25 billion outstanding at any one time. This facility has not been used since Fannie Mae's transition from government ownership in 1968. Neither the United States nor any agency thereof is obligated to finance Fannie Mae's operations or to assist Fannie Mae in any other manner. The Federal Reserve Banks are authorized to act as depositories, custodians, and fiscal agents for Fannie Mae, for its own account, or as fiduciary.

Fannie Mae is exempt from all taxation by any state or by any county, municipality, or local taxing authority except for real property taxes. Fannie Mae is not exempt from payment of federal corporate income taxes. Also, Fannie Mae may conduct its business without regard to any qualifications or similar statute in any state of the United States or the District of Columbia.

RECENT DEVELOPMENTS

Fannie Mae made initial disclosures of interest rate risk and credit risk sensitivities and results of a self-implemented interim risk-based capital test as part of its voluntary initiatives announced in October 2000. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Regulatory Environment” for an overview of the voluntary initiatives. The following is a detailed description of the interest rate risk and credit risk sensitivity analyses and disclosures and the results of the interim risk-based capital stress test.

Interest Rate Risk

Net interest income at risk compares Fannie Mae’s projected net interest income under a 50 basis point increase or decrease in interest rates and a 25 basis point increase or decrease in the slope of the yield curve with projected net interest income without these interest rate changes. Fannie Mae’s net interest income at risk incorporates future activities in line with Fannie Mae’s one- and four-year business projections. Yield curve slope sensitivity is calculated assuming a 25 basis point flattening or steepening between one-year and ten-year maturities, with the five-year yield held constant. A 50 basis point change in interest rates and a 25 basis point change in the slope of the yield curve encompass about 95 percent of the actual changes that are likely to occur over a monthly reporting period, in management’s estimate. Fannie Mae generally expects its net interest income at risk measures to range between 1 and 5 percent.

As of February 28, 2001, Fannie Mae’s net interest income at risk from a 50 basis point instantaneous change in interest rates was 3.0 percent over the next year and 2.1 percent over the next four years. The company’s net interest income at risk from a 25 basis point change in the slope of the yield curve was 3.2 percent over the next year and 5.2 percent over the next four years.

Effective asset/liability duration gap is a measure of the sensitivity of a portfolio’s value to changes in interest rates. In computing duration gap, Fannie Mae uses a modified option-adjusted duration calculation. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Risk Management—Interest Rate Risk Management” for further information on how Fannie Mae uses duration gap to help monitor interest rate risk and its level at year-end 2000.

As of February 28, 2001, the effective duration gap of Fannie Mae’s mortgage portfolio was a negative two months. A negative duration gap indicates that the effective duration of a portfolio’s liabilities exceeds the effective duration of its assets by that amount, while a positive duration gap indicates the opposite. Fannie Mae’s effective duration gap was a negative three months at both December 31, 2000 and January 31, 2001.

The table below presents monthly duration gap and net interest income at risk results from December 1999 to February 2001.

<u>For the Month ending</u>	<u>Month-end Duration Gap</u>	<u>Rate Level Shock (50bp)</u>		<u>Rate Slope Shock (25bp)</u>	
		<u>Net Interest Income at Risk: 1 year Portfolio</u>	<u>Net Interest Income at Risk: 4 year Portfolio</u>	<u>Net Interest Income at Risk: 1 year Portfolio</u>	<u>Net Interest Income at Risk: 4 year Portfolio</u>
December 31, 1999	7	0.2%	4.0%	0.7%	2.1%
January 31, 2000	8	0.2	4.6	0.7	2.3
February 29, 2000	6	0.2	2.8	0.9	2.8
March 31, 2000	5	0.1	4.3	1.0	3.0
April 30, 2000	6	0.0	4.8	1.0	2.9
May 31, 2000	6	0.4	5.1	1.0	2.9
June 30, 2000	4	0.6	4.8	1.0	3.0
July 31, 2000	4	0.9	5.0	0.9	2.8
August 31, 2000	2	0.8	4.3	0.9	3.1
September 30, 2000	2	0.8	4.3	1.0	3.1
October 31, 2000	1	0.8	3.9	1.1	3.4
November 30, 2000	-1	1.2	3.2	1.3	3.9
December 31, 2000	-3	0.5	2.0	3.0	4.3
January 31, 2001	-3	3.9	3.6	3.6	5.2
February 28, 2001	-2	3.0	2.1	3.2	5.2

Credit Risk

Fannie Mae's *credit risk sensitivity* analysis estimates the change in projected credit losses assuming a five percent decline in home prices. Fannie Mae's credit risk sensitivity is presented both on a net basis (including the beneficial effect of credit enhancements) and a gross basis (excluding the effect of credit enhancements). In calculating credit risk sensitivity, Fannie Mae first projects the present value of all future credit losses using internal credit models, then calculates the present value of losses assuming an immediate five percent decline in the value of all single-family properties securing mortgages owned or guaranteed by Fannie Mae. Following this decline, home prices are assumed to increase at the same long-run rate projected by Fannie Mae's credit pricing models. Projected default incidence and severity are consistent with the assumed changes in home prices.

As of December 31, 2000, Fannie Mae's net sensitivity of future credit losses from a five percent decline in home prices, taking into account the effect of credit enhancements, was \$295 million. This amount reflects a gross credit loss sensitivity of \$1,065 million without the effect of credit enhancements. Fannie Mae's net credit risk sensitivity can be expected to vary over time based on a number of factors, including the composition of Fannie Mae's credit portfolio, recent home price changes, the level of interest rates, and the amount of mortgage insurance and other credit enhancements that reduce Fannie Mae's losses.

Risk-Based Capital Stress Test

For purposes of voluntary disclosure, Fannie Mae has implemented an internal, *interim version of the risk-based capital stress test* detailed in the 1992 Act. This internal risk-based capital stress test uses as its basis Part II of OFHEO's proposed regulations, modified to reflect subsequent changes published by OFHEO, changes suggested in Fannie Mae's comment letter on Part II, and certain additional adjustments to the calculation of the Treasury yield curve slope, Fannie Mae's borrowing costs, home price inflation, debt refunding, capital distributions, administrative expenses, and calculation of required capital. See "Government Regulation and Charter Act" for further information on the 1992 Act and OFHEO's proposed regulations. OFHEO has not commented on, nor given any indication that it supports, Fannie Mae's interim version of the risk-based capital stress test. Fannie

Mae will disclose this interim implementation only until the final risk-based capital standard is adopted by OFHEO.

Fannie Mae passed its internal, interim risk-based capital stress test as of December 31, 2000. Its capital cushion on December 31, 2000 was between 10 and 30 percent of total capital. Fannie Mae's intent was to manage its risks so that the cushion between total capital and calculated risk-based capital would be at least 10 percent of total capital.

LEGAL PROCEEDINGS

In the ordinary course of business, Fannie Mae is involved in legal proceedings that arise in connection with properties acquired either through foreclosure on properties securing delinquent mortgage loans owned by Fannie Mae or by receiving deeds to such properties in lieu of foreclosure. For example, claims related to possible tort liability and compliance with applicable environmental requirements arise from time to time, primarily in the case of single-family REO.

Fannie Mae is a party to legal proceedings from time to time arising from its relationships with its seller/servicers. Disputes with lenders concerning their loan origination or servicing obligations to Fannie Mae, or disputes concerning termination by Fannie Mae (for any of a variety of reasons) of a lender's authority to do business with Fannie Mae as a seller and/or servicer, can result in litigation. Also, loan servicing issues have resulted from time to time in claims against Fannie Mae brought as putative class actions for borrowers.

Fannie Mae also is a party to legal proceedings from time to time arising from other aspects of its business and administrative policies. Claims and proceedings of all types are subject to many uncertain factors that generally cannot be predicted with assurance. However, in the case of the legal proceedings and claims that are currently pending against Fannie Mae, management believes that their outcome will not have a material adverse effect on Fannie Mae's financial condition or results of operations.

COMMON AND PREFERRED STOCK

Section 303(a) of the Charter Act provides that Fannie Mae shall have common stock, without par value. The common stock is vested with all voting rights. Each share of common stock is entitled to one vote at all elections of directors and on all other matters presented for common shareholder vote. The common stock has no conversion or pre-emptive rights or redemption or sinking fund provisions. The outstanding shares of common stock are fully paid and nonassessable. There is no prohibition against the purchase by Fannie Mae of its own common stock, holding such common stock in its treasury, and reselling such stock. In the event of liquidation of Fannie Mae, holders of common stock are entitled to share ratably, in accordance with their holdings, in the remaining assets of Fannie Mae after payment of all liabilities and amounts payable to the holders of preferred stock. The holders of the common stock elect thirteen directors, and the President of the United States appoints the remaining five directors. The Charter Act, Fannie Mae's governing instrument, cannot be amended by the stockholders, but only by an Act of Congress.

Fannie Mae also is authorized by the Charter Act to have preferred stock on such terms and conditions as the Board of Directors of Fannie Mae may prescribe. No common stockholder approval is required to issue preferred stock. Fannie Mae issued \$1 billion of non-cumulative preferred stock in 1996, \$150 million in 1998, \$150 million in 1999 and \$978 million in 2000 that is redeemable at Fannie Mae's option beginning in 2001, 1999, 2004 and 2002, respectively. Holders of these preferred stock issues are entitled to receive noncumulative, quarterly dividends when, and if, declared by Fannie Mae's Board of Directors. Payment of dividends on preferred stock is not mandatory, but has priority over payment of dividends on common stock. Preferred stock is redeemable at its stated value at the option of Fannie Mae on or after specified dates. Fannie Mae redeemed its outstanding Series A

preferred stock issued in 1996 on March 1, 2001. See “Notes to Financial Statements—Note 12” for additional information on preferred stock.

The Charter Act contains no limitation on the amount of stock that may be issued except that, if Fannie Mae fails to meet certain minimum capital standards, the Director of OFHEO could require the right to approve Fannie Mae’s issuance of stock or securities convertible into stock. At February 28, 2001, there were outstanding approximately 1,000 million shares of common stock. As of December 31, 2000, there were approximately 26,000 stockholders of record. Based on the number of requests for proxies and quarterly reports, Fannie Mae estimates that there are approximately 350,000 additional stockholders who held shares through banks, brokers and nominees.

Holders of common and preferred stock are entitled to receive cash dividends if, as, and when declared by the Board of Directors. However, certain provisions of the 1992 Act may operate to restrict the ability of the Board of Directors to declare dividends in certain circumstances. The 1992 Act established risk-based capital, minimum capital and critical capital requirements for Fannie Mae. OFHEO has released proposed risk-based capital regulations for public review and comment. Until one year after the final regulations establishing the risk-based capital test are in effect, a dividend may be paid without the prior approval of the Director of OFHEO if Fannie Mae meets the minimum capital level and the dividend payment would not decrease Fannie Mae’s base capital below such level. See “Government Regulation and Charter Act.” One year after final regulations establishing the risk-based capital test take effect, a dividend may be paid without the prior approval of the Director if Fannie Mae meets both the risk-based capital and minimum capital levels and the dividend payment would not decrease Fannie Mae’s total capital below the risk-based capital level or its core capital below the minimum capital level. If Fannie Mae meets either the risk-based capital standard or the minimum capital standard, it may make a dividend payment without obtaining the approval of the Director only if the dividend payment would not cause Fannie Mae to fail to meet another capital standard. At any time when Fannie Mae does not meet the risk-based capital standard but meets the minimum capital standard, Fannie Mae is prohibited from making a dividend payment that would cause Fannie Mae to fail to meet the minimum capital standard. If Fannie Mae meets neither the risk-based capital standard nor the minimum capital standard but does meet the critical capital standard established under the 1992 Act, it may make a dividend payment only if Fannie Mae would not fail to meet the critical capital standard as a result of such payment and the Director approves the payment after finding that it satisfies certain statutory conditions. The Director has the authority to require Fannie Mae to submit a report to the Director regarding any capital distribution (including any dividend) declared by Fannie Mae before Fannie Mae makes the distribution. See “Government Regulation and Charter Act” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Regulatory Environment” regarding the capital standards applicable to Fannie Mae.

The payment of dividends on common stock also is subject to the payment of dividends on any preferred stock outstanding. No cash dividend may be declared or paid or set apart for payment on common stock unless cash dividends have been declared and paid or set apart (or ordered to be set apart) on preferred stock outstanding for the current dividend period.

Dividends on common stock have been declared and paid for each quarter during Fannie Mae’s two most recent fiscal years. See “Quarterly Results of Operations” for quarterly dividends paid on common stock during 2000 and 1999.

This description is summarized from the Charter Act, the 1992 Act, the bylaws and certain resolutions of the Board of Directors and stockholders of Fannie Mae. This description does not purport to be complete, and is qualified in its entirety by reference to the Charter Act, the 1992 Act, the bylaws of Fannie Mae, and such resolutions. Copies of the Charter Act, the bylaws of Fannie Mae, and any applicable resolutions may be obtained from Fannie Mae.

Fannie Mae’s common stock is publicly traded on the New York, Pacific, and Chicago stock exchanges and is identified by the ticker symbol “FNM.” The transfer agent and registrar for the

common stock is First Chicago Trust Company of New York, a division of EquiServe, P.O. Box 2598, Jersey City, New Jersey 07303. The following table shows, for the periods indicated, the high and low prices per share of Fannie Mae's common stock on the New York Stock Exchange Composite Transactions as reported in the Bloomberg Financial Markets service.

Quarterly Common Stock Data

<u>Quarter</u>	2000		1999	
	High	Low	High	Low
1st	\$64.88	\$47.88	\$75.88	\$65.50
2nd	65.63	51.25	73.81	62.44
3rd	72.88	48.13	71.63	58.56
4th	89.38	66.13	73.25	59.94

The closing price of Fannie Mae's common stock on March 28, 2001, as so reported, was \$78.40.

FORWARD-LOOKING INFORMATION

From time to time, Fannie Mae may make forward-looking statements relating to matters such as Fannie Mae's anticipated financial performance, business prospects, future business plans, financial condition, or other matters. For example, "Management's Discussion and Analysis of Financial Condition and Results of Operations" includes forward-looking statements, which are statements therein that are not historical facts or explanations of historical data. The words "believes," "anticipates," "expects," "should" and similar expressions generally identify forward-looking statements.

Forward-looking statements reflect management's expectations based on various assumptions and management's estimates of trends and economic factors in the markets in which Fannie Mae is active, as well as Fannie Mae's business plans. As such, forward-looking statements are subject to risks and uncertainties, and Fannie Mae's actual results may differ (possibly significantly) from those indicated in such statements. Among the factors that may affect the performance, development, or results of Fannie Mae's business, and thereby cause actual results to differ from management's expressed expectations, are the following:

- significant changes in borrower preferences for fixed- or adjustable-rate mortgages, originator preferences for selling mortgages in the secondary market, investor preferences for Fannie Mae's securities versus other investments, the availability of funding at attractive spreads in the financial markets (in particular from callable debt), and other factors affecting the overall mix of mortgage loans available for purchase, Fannie Mae's funding opportunities, or Fannie Mae's net interest margins;
- significant changes in employment rates, housing price appreciation, or other factors affecting delinquency or foreclosure levels and credit losses;
- significant changes in Fannie Mae's policies or strategies, such as its underwriting requirements or its interest rate risk management, credit loss mitigation, or investment strategies;
- regulatory or legislative changes affecting Fannie Mae, its competitors, or the markets in which Fannie Mae is active, including changes in taxes or capital requirements applicable to Fannie Mae or its activities (see "Government Regulation and Charter Act," and "Management's Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Regulatory Environment" regarding certain matters currently being considered by regulators, legislators, or the Administration);

- competitive developments in the markets for mortgage loan purchases and for the sale of mortgage-backed and debt securities, or significant changes in the rate of growth in conforming residential mortgage debt;
- significant changes in the amount and rate of growth of Fannie Mae's expenses, and the costs (and effects) of legal or administrative proceedings (see "Legal Proceedings") or changes in accounting policies or practices;
- significant changes in general economic conditions or the monetary or fiscal policy of the United States; and
- unanticipated, substantial changes in interest rates. It is possible that sudden, severe swings in interest rates could have at least a short-term significant effect on Fannie Mae's results.

Fannie Mae does not undertake to update any forward-looking statement herein or that may be made from time to time on behalf of Fannie Mae.

SELECTED FINANCIAL INFORMATION: 1996-2000

The following selected financial data for the years 1996 through 2000 (which data are not covered by the independent auditors' report) have been summarized or derived from the audited financial statements and other financial information. These data should be read in conjunction with the audited financial statements and notes to the financial statements.

(Dollars in millions, except per common share amounts)					
Income Statement Data for the year ended December 31:	2000	1999	1998	1997	1996
Interest income	\$ 42,781	\$ 35,495	\$ 29,995	\$ 26,378	\$ 23,772
Interest expense	(37,107)	(30,601)	(25,885)	(22,429)	(20,180)
Net interest income	5,674	4,894	4,110	3,949	3,592
Guaranty fee income	1,351	1,282	1,229	1,274	1,196
Fee and other income (expense)	(44)	191	275	125	86
Credit-related expenses	(94)	(127)	(261)	(375)	(409)
Administrative expenses	(905)	(800)	(708)	(636)	(560)
Income before federal income taxes and extraordinary item	5,982	5,440	4,645	4,337	3,905
Provision for federal income taxes	(1,566)	(1,519)	(1,201)	(1,269)	(1,151)
Income before extraordinary item	4,416	3,921	3,444	3,068	2,754
Extraordinary item—gain (loss) on early extinguishment of debt, net of tax effect	32	(9)	(26)	(12)	(29)
Net income	<u>\$ 4,448</u>	<u>\$ 3,912</u>	<u>\$ 3,418</u>	<u>\$ 3,056</u>	<u>\$ 2,725</u>
Preferred stock dividends	(121)	(78)	(66)	(65)	(42)
Net income available to common shareholders	<u>\$ 4,327</u>	<u>\$ 3,834</u>	<u>\$ 3,352</u>	<u>\$ 2,991</u>	<u>\$ 2,683</u>
Basic earnings per common share(1):					
Earnings before extraordinary item	\$ 4.28	\$ 3.75	\$ 3.28	\$ 2.87	\$ 2.53
Extraordinary item .....	.03	—	(.02)	(.02)	(.03)
Net earnings	<u>\$ 4.31</u>	<u>\$ 3.75</u>	<u>\$ 3.26</u>	<u>\$ 2.85</u>	<u>\$ 2.50</u>
Diluted earnings per common share(1):					
Earnings before extraordinary item	\$ 4.26	\$ 3.73	\$ 3.26	\$ 2.84	\$ 2.51
Extraordinary item .....	.03	(.01)	(.03)	(.01)	(.03)
Net earnings	<u>\$ 4.29</u>	<u>\$ 3.72</u>	<u>\$ 3.23</u>	<u>\$ 2.83</u>	<u>\$ 2.48</u>
Cash dividends per common share	\$ 1.12	\$ 1.08	\$.96	\$.84	\$.76
Balance Sheet Data at December 31:					
Mortgage portfolio, net	\$ 607,399	\$ 522,780	\$ 415,223	\$ 316,316	\$ 286,259
Investments	54,968	39,751	58,515	64,596	56,606
Total assets	675,072	575,167	485,014	391,673	351,041
Borrowings:					
Due within one year	280,322	226,582	205,413	175,400	159,900
Due after one year	362,360	321,037	254,878	194,374	171,370
Total liabilities	654,234	557,538	469,561	377,880	338,268
Stockholders' equity	20,838	17,629	15,453	13,793	12,773
Capital(2)	21,645	18,430	16,244	14,575	13,520
Other Data for the year ended December 31:					
Average net interest margin	1.01%	1.01%	1.03%	1.17%	1.18%
Return on average common equity	25.6	25.2	25.2	24.6	24.1
Dividend payout ratio	26.0	28.8	29.5	29.4	30.4
Average effective guaranty fee rate .....	.195	.193	.202	.227	.224
Credit loss ratio .....	.007	.011	.027	.041	.053
Ratio of earnings to combined fixed charges and preferred stock dividends(3)	1.16:1	1.17:1	1.18:1	1.19:1	1.19:1
Mortgage purchases	\$ 154,231	\$ 195,210	\$ 188,448	\$ 70,465	\$ 68,618
MBS issued	211,662	300,689	326,148	149,429	149,869
MBS outstanding at year-end(4)	1,057,750	960,883	834,518	709,582	650,780
Weighted-average diluted common shares outstanding, in millions	1,009	1,031	1,037	1,056	1,080

(1) Earnings per common share amounts prior to 1997 have been restated to comply with Statement of Financial Accounting Standards No. 128, *Earnings per Share*.

(2) Stockholders' equity plus general allowance for losses.

(3) "Earnings" consists of (i) income before federal income taxes and extraordinary item and (ii) fixed charges. "Fixed charges" represents interest expense.

(4) Includes \$351 billion, \$282 billion, \$197 billion, \$130 billion, and \$103 billion of MBS in portfolio at December 31, 2000, 1999, 1998, 1997, and 1996, respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion highlights significant factors influencing Fannie Mae's financial condition and results of operations. It should be read in conjunction with the financial statements and related notes. This discussion (and other sections of this information statement) includes certain forward-looking statements based on management's estimates of trends and economic factors in markets in which Fannie Mae is active, as well as the corporation's business plans. In light of securities law developments, including the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, Fannie Mae notes that such forward-looking statements are subject to risks and uncertainties. Accordingly, the corporation's actual results may differ from those set forth in such statements. Significant changes in economic conditions; regulatory or legislative changes affecting Fannie Mae, its competitors, or the markets in which it is active; or changes in other factors may cause future results to vary from those expected by Fannie Mae. The "Forward-Looking Information" section discusses certain factors that may cause such differences to occur.

Overview

Fannie Mae generated earnings of \$4.448 billion in 2000, an increase of \$536 million over 1999, and posted its 14th consecutive year of record earnings. Diluted earnings per common share increased 15 percent to \$4.29 per share in 2000, keeping Fannie Mae on track to reach its five-year goal of doubling earnings per share by 2003.

Fannie Mae's earnings performance in 2000 was driven by a 12 percent increase in total taxable-equivalent revenues, up one percentage point compared with 1999. The solid growth in taxable-equivalent revenues was paced by 18 percent growth in the average retained mortgage portfolio combined with a stable average net interest margin. Earnings also benefited from a 28 percent decline in credit losses to their lowest level since 1983, when Fannie Mae's total book of business (the retained mortgage portfolio and Fannie Mae guaranteed mortgage-backed securities held by third-party investors) was a tenth of its current size.

The remainder of Management's Discussion and Analysis (MD&A) includes detailed information on Fannie Mae's results of operations, risk management, balance sheet, mortgage-backed securities, and housing goals in 2000 compared with 1999 and should be read in conjunction with the financial statements and the notes to the financial statements. In addition, MD&A includes forward-looking statements about 2001, information about the expected impact of new accounting standards, and a comparison of results of operations in 1999 with 1998.

Results of Operations

Taxable-Equivalent Revenues

Taxable-equivalent revenues totaled \$7.825 billion in 2000, up 12 percent over 1999. Taxable-equivalent revenues include revenues net of operating losses on certain tax-advantaged investments plus taxable-equivalent adjustments for tax-exempt income and investment tax credits using the applicable federal income tax rate. The \$850 million increase in 2000 was largely attributable to solid growth in net interest income, an increase in tax credits from investments in affordable housing, and interest income from investments in tax-exempt securities. Management expects that taxable-equivalent revenues will grow at a somewhat faster pace in 2001 primarily because of projected increases in net interest income, tax credits from affordable housing investments, and income from tax-exempt investments. Table 1 presents a comparison of taxable-equivalent revenues for 2000 and 1999.

Table 1: Taxable-Equivalent Revenues

	<u>Year Ended December 31,</u>	
	<u>2000</u>	<u>1999</u>
	(Dollars in millions)	
Net interest income	\$5,674	\$4,894
Guaranty fee income.....	1,351	1,282
Fee and other income (expense)	<u>(44)</u>	<u>191</u>
Total revenues	6,981	6,367
Taxable-equivalent adjustments(1):		
Investment tax credits	430	267
Tax-exempt investments	<u>414</u>	<u>341</u>
Total taxable-equivalent revenues	<u>\$7,825</u>	<u>\$6,975</u>

(1) Adjusted using the applicable federal income tax rate.

Net Interest Income

Net interest income increased \$780 million to \$5.674 billion in 2000, a 16 percent increase over 1999, as the average retained mortgage portfolio grew 18 percent and the average net interest margin remained stable. Retained mortgage portfolio growth was particularly strong in the second half of the year as interest rates trended downward, boosting fixed-rate mortgage origination volumes in the primary market and improving mortgage-to-debt spreads. Mortgage-to-debt spread is the difference between the yield on a mortgage and the cost of debt that funds it. Retained portfolio growth during the second half of the year was fueled by financial institutions selling a large amount of new and seasoned mortgages into the secondary market. This created attractive investment opportunities at solid mortgage-to-debt spreads. Management expects the growth rate in net interest income to increase in 2001 in line with projected retained mortgage portfolio growth.

Additional information on mortgage portfolio volumes and yields as well as the cost of debt is presented in MD&A under “Balance Sheet Analysis.”

Guaranty Fee Income

Guaranty fee income increased \$69 million in 2000 to \$1.351 billion, up 5 percent over 1999. This gain was due to 4 percent growth in average net Fannie Mae MBS outstanding (exclusive of MBS held in Fannie Mae’s mortgage portfolio) together with a slight increase in the average effective guaranty fee rate. Guaranty fees compensate Fannie Mae for the assumption of credit risk associated with its guarantee of the timely payment of principal and interest to MBS investors. Guaranty fee income includes only fees received on MBS that Fannie Mae does not hold in portfolio. The average guaranty fee rate increased slightly because of slower growth in the percentage of MBS with credit-sharing arrangements, an increase in higher fee-rate business, and a decline in the liquidation of older, higher fee-rate business. For 2001, management anticipates guaranty fee income growth will slow because of a decline in the average effective guaranty fee rate due to the impact of higher projected prepayments. Table 2 presents the average effective guaranty fee rate for the past three years.

Table 2: Guaranty Fee Data

	Year Ended December 31,		
	2000	1999	1998
	(Dollars in millions)		
Guaranty fee income	\$ 1,351	\$ 1,282	\$ 1,229
Average balance of net MBS outstanding	694,165	664,672	609,513
Average effective guaranty fee rate . . . . .	.195%	.193%	.202%

Additional information on Fannie Mae’s MBS and guaranty fees is presented in MD&A under “Mortgage-Backed Securities.”

Fee and Other Income (Expense)

Fee and other income (expense) declined to an expense of \$44 million in 2000 from income of \$191 million in 1999. Fee and other income (expense) consists of technology fees, transaction fees, multifamily fees, as well as other miscellaneous items, and is net of operating losses from certain tax-advantaged investments. The \$235 million decline was primarily because of an increase in net operating losses from certain tax-advantaged investments and a decline in other miscellaneous income. Net operating losses from certain tax-advantaged investments increased \$134 million because of a higher volume of equity investments in affordable housing projects. Investments in affordable housing projects generate tax credits that reduce Fannie Mae’s effective federal income tax rate, with the tax benefits recorded as a reduction in the provision for federal income taxes and an increase in taxable-equivalent revenues. Other miscellaneous income decreased \$85 million primarily because of a hedging loss on an anticipated Benchmark Note issuance. The hedge fell out of correlation due to a dislocation in the agency markets early in the second quarter of 2000.

Management expects that fee and other income (expense) will improve in 2001. Fannie Mae does not expect a recurrence of the hedging loss recorded in 2000, and it anticipates slower growth in net operating losses from equity investments in affordable housing projects as well as an increase in technology fees from greater usage of Fannie Mae’s Desktop Underwriter and Desktop Originator systems.

Additional information about structured transactions is presented in MD&A under “Mortgage-Backed Securities.” Additional information about multifamily investments is presented in MD&A under “Risk Management—Credit Risk Management.”

Credit-Related Expenses

Credit-related expenses, which include foreclosed property expenses and the provision for losses, declined \$33 million to \$94 million in 2000 from \$127 million in 1999 despite continued growth in Fannie Mae’s total book of business. Credit-related losses, which include foreclosed property expenses and charge-offs (net of recoveries), fell as a percentage of Fannie Mae’s average book of business to .7 basis points in 2000 from 1.1 basis points in 1999.

The improvement in credit performance was attributable to continued strength in the nation’s economy and housing markets combined with successful credit risk management strategies, including increased usage of automated underwriting technology, effective use of credit enhancements, and well-executed loss mitigation strategies. Foreclosed property expenses decreased \$33 million in 2000, or 13 percent compared with 1999, to \$214 million largely because of a decline in the number of foreclosed single-family property acquisitions to 14,351 in 2000 from 16,806 in 1999. The provision for losses remained stable in 2000 at a negative provision of \$120 million, following Fannie Mae’s current policy of recording a negative loss provision in line with recoveries on charged-off properties. Management expects that credit-related expenses will increase somewhat in 2001 from their low levels in 2000; however, Fannie Mae’s credit performance should remain strong in 2001 with credit losses as a percentage of its average book of business up slightly from 2000 levels.

Additional information on credit-related expenses and credit-related losses is presented in MD&A under “Risk Management—Credit Risk Management.”

Administrative Expenses

Administrative expenses grew 13 percent to \$905 million in 2000, compared with \$800 million in 1999, primarily because of increased investment in our eBusiness technology, Single-family Mortgage Business infrastructure, and housing and community development initiatives. However, the ratio of administrative expenses to total taxable-equivalent revenues increased only slightly to 11.6 percent in 2000 from 11.5 percent in 1999 and the ratio of administrative expenses to the average book of business increased slightly to 7.2 basis points in 2000 from 7.1 basis points in 1999. Compensation expense increased to \$541 million in 2000 from \$496 million in 1999 as part of the aforementioned investments. Management expects that administrative expenses will increase at a somewhat slower rate than taxable-equivalent revenues in 2001.

Income Taxes

The provision for federal income taxes, net of the tax impact from debt extinguishments, increased to \$1.583 billion in 2000 from \$1.514 billion in 1999. The effective federal income tax rate decreased to 26 percent in 2000 from 28 percent in 1999. The reduction in the 2000 effective federal income tax rate was primarily attributable to increased tax credits from a higher volume of investments in affordable housing projects. Management expects the effective tax rate will continue to decline in 2001 largely because of tax credits from increased investments in affordable housing.

Extraordinary Item

For 2000, Fannie Mae recognized extraordinary gains of \$49 million (\$32 million after tax), compared with extraordinary losses of \$14 million (\$9 million after tax) in 1999, attributable to the extinguishment of debt. Fannie Mae recognized most of the extraordinary gains in the second quarter of 2000 when it repurchased debt that was trading at a low market price relative to historical levels. The same market conditions that caused the hedging loss in the second quarter of 2000 created the opportunity to repurchase debt at a favorable price.

Extraordinary gains or losses are recognized when debt and related interest rate swaps are repurchased or called. The repurchase and call of debt and related interest rate swaps are part of Fannie Mae’s interest rate risk management strategy and are designed to benefit Fannie Mae’s future cost of funds.

During 2000, Fannie Mae retired \$18 billion in debt and notional principal of interest rate swaps carrying a weighted-average cost of 7.10 percent. The comparable amount in 1999 was \$42 billion at 6.80 percent.

Risk Management

Fannie Mae is subject to three major areas of risk: interest rate risk, credit risk, and operations risk. Active management of these risks is an essential part of Fannie Mae’s operations and a key determinant of its ability to maintain steady earnings growth. The following discussion highlights Fannie Mae’s strategies to manage these three risks.

Interest Rate Risk Management

Fannie Mae is exposed to interest rate risk because changes in interest rates may affect mortgage portfolio cash flows in a way that will adversely impact earnings or long-term value. Fannie Mae’s management of interest rate risk involves analyses and actions that position the company to meet its objective of consistent earnings growth in a wide range of interest rate environments. Fannie Mae’s interest rate risk is concentrated primarily in the retained mortgage portfolio, where exposure to

changes in interest rates is managed to achieve stable earnings growth and a competitive return on equity over time. Central elements of Fannie Mae's approach to managing interest rate risk include: (1) investing in assets and issuing liabilities that perform similarly in different interest rate environments, (2) assessing the sensitivity of portfolio profitability and risk to changes in interest rates, and (3) taking rebalancing actions in the context of a well-defined risk management process.

The first element of interest rate risk management is the funding of mortgage assets with liabilities that have similar cash flow patterns to those assets through time and across different interest rate paths. To achieve the desired liability durations, Fannie Mae issues debt across a broad spectrum of final maturities. Because the durations of mortgage assets change as interest rates change, callable debt and interest rate derivatives are frequently used to alter the durations of liabilities. The duration of callable debt, like that of a mortgage, shortens when interest rates decrease and lengthens when interest rates increase. Fannie Mae also uses off-balance-sheet derivative financial instruments, including interest rate swaps and other derivatives with embedded interest rate options, to achieve its desired liability structure and to better match the prepayment risk of the mortgage portfolio. These instruments are close substitutes for callable debt.

Because the assets in Fannie Mae's mortgage portfolio are not perfectly matched with the liabilities funding those assets, the portfolio's projected performance changes with movements in interest rates. Accordingly, the second element of interest rate risk management involves regularly assessing the portfolio's risk using a diverse set of analyses and measures, including net interest income at risk, duration and convexity analysis, portfolio value analyses, and stress testing. Risk measures and assumptions are regularly evaluated and modeling tools are enhanced as management finds appropriate.

Portfolio net interest income is projected for a wide range of interest rate environments, including specific rising and falling interest rate paths, using stochastic interest rate simulations based on historical interest rate volatility. Stochastic simulations generate probability distributions of future interest rates based on historic behavior. These analyses generally include assumptions about new business activity to provide a more realistic assessment of possible portfolio performance. Fannie Mae also regularly conducts narrower assessments of interest rate risk by analyzing the interest rate sensitivity of only the existing retained mortgage portfolio (assuming no new business).

The duration and convexity of the portfolio, along with portfolio value and net interest income at risk analyses, are the primary risk assessment tools used to analyze the existing portfolio. The portfolio duration gap—the difference between the durations of portfolio assets and liabilities—summarizes for management the extent to which estimated cash flows for assets and liabilities are matched, on average, through time and across interest rate scenarios. A positive duration gap indicates more of an exposure to rising interest rates, and a negative duration gap indicates more of an exposure to declining interest rates. The portfolio's convexity—or the difference between the duration sensitivities of the portfolio's assets and liabilities—provides management with information on how quickly and by how much the portfolio's duration gap will change in different interest rate environments. Management regularly monitors the portfolio's duration and convexity under current market conditions and for a series of hypothetical interest rate shocks. In addition, management tracks the portfolio's long-term value and the amount of value that is at risk over a broad range of potential interest rate scenarios.

Net interest income at risk, duration, convexity, and portfolio value analyses all provide key information about risk across a wide range of interest rates. Because future events may not be consistent with recent experience, Fannie Mae has constructed a further series of tests using highly stressful assumptions of changes in interest rates.

Many of the projections of mortgage cash flows depend on prepayment models. Fannie Mae is highly confident in the quality of these models, but is aware that the models are based on historical patterns that may not continue in the future. The models contain many assumptions, including some regarding the refinancability of mortgages and relocation rates. Other assumptions are implicit in the

projections of interest rates and include projections of the shape of the yield curve and volatility. Fannie Mae constructs “worst-case” assumptions of dramatic changes in interest rates, combined with substantial adverse changes in prepayments, volatility, and the shape of the yield curve. The stress tests provide extreme measures of potential risk in highly improbable environments and contribute to the evaluation of risk strategies.

The third element of Fannie Mae’s interest rate risk management is a framework that sets the parameters for rebalancing actions to help attain corporate objectives. The Board of Directors oversees interest rate risk management through the adoption of corporate goals and objectives and the review of regular reports on performance against them. Senior management is responsible for ensuring that appropriate long-term strategies are in place to achieve the goals and objectives. Management establishes reference points for the key performance measures that are used to signal material changes in risk and to assist in determining whether adjustments in portfolio strategy are required to achieve long-term objectives. These measures and reference points are reported regularly to the Board of Directors. Comparing the performance measures with the reference points helps management decide about the necessity or desirability of portfolio rebalancing. Short-term strategies, including rebalancing actions, are formulated in weekly meetings of senior mortgage portfolio management on the basis of recent financial market information and the portfolio’s standing relative to its long-term objectives.

Fannie Mae’s practice of employing a variety of risk measures and assumptions continued to prove beneficial during 2000. Although interest rates were not as volatile as in the previous two years, there was still significant movement in interest rates during 2000. The ten-year Fannie Mae debt cost rose briefly but sharply in the spring of 2000 and trended lower throughout the rest of the year. Fannie Mae’s ten-year debt cost fell by more than 100 basis points between year-end 1999 and year-end 2000. Management was able to meet its interest rate risk management objectives despite these movements in interest rates.

Fannie Mae’s duration gap was negative three months at December 31, 2000, within its target range of plus or minus six months, and was an improvement from a positive seven month duration gap at December 31, 1999. Fannie Mae’s duration gap declined as a result of the decrease in interest rates during 2000.

Fannie Mae also effectively managed its convexity risk to optimize the earnings potential of its portfolio while staying comfortably within corporate risk guidelines. Fluctuations in interest rate volatility and market pricing during 2000 provided Fannie Mae an opportunity to vary the purchase pattern of option protection used to hedge the convexity risk of the portfolio. During the first three quarters of the year, Fannie Mae reduced the portfolio’s convexity exposure by increasing the total amount of option-embedded debt. By the end of the third quarter, option-embedded debt as a percentage of the retained mortgage portfolio increased to 49 percent from 47 percent at year-end 1999. As a result, Fannie Mae increased mortgage purchases and modestly raised convexity exposure during the latter part of 2000.

Net Interest Income at Risk

Fannie Mae’s net interest income at risk analyses estimate that the portfolio’s forecasted net interest income has very limited exposure to projected changes in interest rates over a one-year horizon and a fairly limited exposure over a four-year horizon. Table 3 presents Fannie Mae’s assessment of the impact of changes in interest rates on the portfolio’s forecasted net interest income using stochastic interest rate simulations based on historical interest rate volatility.

Table 3: Net Interest Income at Risk

	<u>Percentage of One-year Forecast</u>	<u>Percentage of Four-year Forecast</u>
Assuming a 100 basis point increase	98%	95%
Assuming a 100 basis point decrease	98	91

The interest rate simulations are based upon a 100 basis point instantaneous change in interest rates followed by a stochastic interest rate distribution for the one-year and four-year periods. For 2001, Fannie Mae's net interest income at risk is estimated to be 2 percent of the portfolio's forecasted net interest income for the period assuming a 100 basis point increase or decrease in interest rates. Over a four-year period, Fannie Mae projects that its net interest income at risk should not exceed 9 percent of the portfolio's forecasted net interest income assuming a 100 basis point decrease in interest rates. Actual portfolio net interest income may differ from these estimates because of specific interest rate movements, changing business conditions, changing prepayments, and management actions.

Interest Rate Sensitivity of Net Asset Value

Another indicator of the interest rate exposure of Fannie Mae's existing business is the sensitivity of the fair value of net assets (net asset value) to changes in interest rates. Table 4 presents Fannie Mae's estimated net asset value as of December 31, 2000 and two estimates of net asset value that are based on hypothetical plus and minus 100 basis point instantaneous shocks in interest rates.

Table 4: Interest Rate Sensitivity of Net Asset Value

	<u>Net Asset Value</u>	<u>Percentage of December 31, 2000 Net Asset Value</u>
	(Dollars in millions)	
December 31, 2000	\$20,677	—
Assuming a 100 basis point increase	20,204	98%
Assuming a 100 basis point decrease	14,822	72

The net asset value of Fannie Mae on December 31, 2000, as presented in the above table, is the same as that disclosed in the Notes to Financial Statements under Note 15, "Disclosures of Fair Value of Financial Instruments." The net asset values for the hypothetical interest rate scenarios were derived in a manner consistent with the estimation procedures described in that note. The net asset value sensitivities do not necessarily represent the changes in Fannie Mae's net asset value that would actually occur for the given interest rate scenarios because the sensitivities neither reflect the effects of new business nor consider prospective asset/liability rebalancing or other hedging actions Fannie Mae might take in the future. Consequently, net interest income at risk more closely reflects the near-term interest rate risk exposure that Fannie Mae faces as a going concern.

Changes in net asset value take into account several factors, including changes in the values of all mortgage assets and the debt funding these assets, changes in the value of net guaranty fee income from off-balance-sheet obligations, and changes in the value of interest rate derivatives. As indicated in Table 4, the net asset value of Fannie Mae's December 31, 2000 book of business would decline an estimated 2 percent from an instantaneous 100 basis point increase in interest rates and would decline an estimated 28 percent from an instantaneous 100 basis point decrease in interest rates. These sensitivities are consistent with Fannie Mae's overall greater exposure to declining interest rates as reflected both by its three month negative duration gap and its net interest income at risk exposure at year-end 2000.

Additional information on interest rate risk management is presented in MD&A under “Balance Sheet Analysis—Financing Activities.”

Credit Risk Management

Fannie Mae actively manages credit risk because credit losses could have a significant impact on financial performance. Fannie Mae’s primary credit risk is the possibility of failing to recover amounts due from borrowers on mortgages in its retained portfolio or mortgages underlying guaranteed MBS. Fannie Mae’s secondary credit risk is that counterparties in other transactions, such as derivatives, mortgage insurance, recourse, liquidity investments, or mortgage servicing, may be unable to meet their contractual obligations.

Fannie Mae’s overall objective in managing credit risk is to deliver consistent earnings and target returns on capital for the risks it retains and manages. Fannie Mae’s credit risk management organization and strategy are integrated within each business unit, which helps provide a consistent and aggregate view of credit risk to achieve corporate objectives. Fannie Mae regularly monitors credit risk trends and explores risk management options. Analytical tools are used extensively to measure credit risk exposures and evaluate risk management alternatives. Fannie Mae continually refines its methods of measuring credit risk, setting risk and return targets, and transferring risk to third parties. Accordingly, Fannie Mae employs various types of credit enhancements to rebalance credit risks in its total book of business.

Fannie Mae’s Credit Committee has primary oversight and approval of its credit risk management strategy. The committee ensures that Fannie Mae’s credit risks are appropriately identified, measured, and managed in a consistent manner. Fannie Mae’s Chief Credit Officer chairs the committee and is joined by leaders of Fannie Mae’s credit risk management team and business unit credit officers. Three main credit risk management teams support the Chief Credit Officer and the committee:

- Policy and Standards—Establishes and monitors credit policies, standards, and delegation of credit authority throughout the organization.
- Credit Portfolio Management—Responsible for understanding and managing the aggregate risk exposure, risk sensitivity, and usage of risk capital, including the identification of risk concentrations and the usage of risk sharing tools. Also responsible for translating key elements of loan performance and credit pricing methodologies into financial models and applications.
- Counterparty Risk Management—Responsible for identifying exposure to contractual counterparties and aggregating Fannie Mae’s overall counterparty risk position. Also develops counterparty risk management policies that identify relevant risks and acceptable exposure limits for Fannie Mae.

These credit risk management teams work in concert with designated credit officers in the following business units: Mortgage Portfolio, eBusiness, Single-family, Multifamily, and Housing and Community Development. The business unit credit officers help ensure that the management of credit risk and return is effectively integrated into Fannie Mae’s business activities. The business unit credit officers have been delegated credit approval authority up to certain thresholds for specific transactions in their respective lines of business.

The credit risk management teams also work closely with Fannie Mae’s five regional offices. The regional offices are responsible for managing Fannie Mae’s customer relationships. The regional offices ensure that Fannie Mae’s transactions with lender partners meet established policies and standards, are appropriately priced, and are effectively managed. The regional offices have been delegated credit authority up to certain thresholds to develop customized mortgage product solutions for lenders while maintaining Fannie Mae’s track record for prudent credit risk management.

The discussion that follows addresses how Fannie Mae specifically manages the risk that it will not recover amounts due from borrowers on conventional single-family and multifamily mortgage loans in the retained portfolio or underlying guaranteed MBS as well as the risk that other counterparties may be unable to meet their contractual obligations.

Single-Family

Fannie Mae actively manages credit risk from the point of acquisition until the termination of single-family mortgages to reduce the risk that it will not recover amounts due from borrowers. Fannie Mae establishes sound underwriting policies to ensure that purchased and securitized mortgages perform in accordance with the level of compensation we receive for the credit risk of the loans. Fannie Mae also deploys portfolio management and loss mitigation strategies to control credit risk throughout the life of purchased and securitized mortgages.

Fannie Mae has developed an automated underwriting tool, Desktop Underwriter, to help lenders consistently and objectively apply Fannie Mae's underwriting standards to prospective borrowers. Desktop Underwriter provides a comprehensive analysis of the unique characteristics of a borrower and mortgage, including such factors as a borrower's credit history and property value. Close to 56 percent of newly originated mortgages sold to Fannie Mae in 2000 were evaluated through Desktop Underwriter, up from 38 percent in 1999. Management expects the usage of Desktop Underwriter by lenders to continue to increase in 2001. To date, loans approved by Desktop Underwriter typically have had lower default rates than those approved using alternate methods.

Fannie Mae continues to explore new ways of using Desktop Underwriter to grow its total book of business while carefully balancing the risk and return of mortgage purchases and securitizations. As the precision of Fannie Mae's risk assessment capabilities in Desktop Underwriter has increased, loans to borrowers formerly obtaining financing in higher cost markets (for example, Alternative A loans and A minus loans) have become eligible for purchase by Fannie Mae. Management plans to continue investing in research and technology to produce tools that help Fannie Mae and lenders assess and manage credit risk, thereby expanding homeownership opportunities.

After purchase, Fannie Mae works closely with its lender partners to minimize credit losses. Many servicers employ Risk ProfilerSM, a default prediction model created by Fannie Mae, to enhance their loss mitigation efforts on loans serviced for Fannie Mae. Risk Profiler uses credit risk indicators, such as updated borrower credit data, current property values, and mortgage product characteristics, to predict the likelihood that a loan will default. Currently, servicers are using Risk Profiler to evaluate close to 90 percent of the loans Fannie Mae owns or guarantees. In addition, Fannie Mae employs Risk Profiler to monitor default probability trends in its total book of business.

In the event mortgages have the potential to become seriously delinquent, Fannie Mae employs strategies to reduce its exposure to loss through resolutions other than foreclosure. Fannie Mae pursues early intervention in a delinquency through mortgage servicers to keep borrowers in their homes and reduce credit-related losses. Borrowers typically are contacted early in a delinquency to determine whether a repayment plan, temporary forbearance, or modification of terms might resolve the delinquency. If this proves unsuccessful, the servicer may arrange a preforeclosure sale to reduce credit-related costs. The benefits of a preforeclosure sale include avoidance of the costs of foreclosure and a tendency for the property to sell at a higher price because the home is usually occupied. Loan workouts outpaced foreclosed property acquisitions for the second year in a row. If a loan modification or preforeclosure sale is not possible, Fannie Mae's goal is to expeditiously and cost effectively handle the foreclosure process to minimize both the time it retains a nonearning asset and the total loss from disposition.

Fannie Mae frequently updates critical data on every mortgage, including the current estimated market value of the property, the amount of equity in the property, and the credit strength of the borrower, to ascertain the current level of credit risk in its total book of business. Fannie Mae uses updated data to analyze the sensitivity of mortgages it owns or guarantees to a wide range of projected

changes in interest rates and home prices. Based on the sensitivity analysis and loan performance analytics, Fannie Mae employs various credit enhancement contracts to protect itself against losses on higher risk loans, including loans with high loan-to-value ratios. Fannie Mae reassesses the efficiency and effectiveness of its credit enhancement contracts and rebalances credit risk to optimize risk management and financial performance. Credit enhancements include primary loan-level mortgage insurance, pool mortgage insurance, recourse arrangements with lenders, and customized contracts, which provided protection against credit losses on 38 percent of single-family mortgages at year-end 2000. In 2000, credit enhancements absorbed \$349 million, or 80 percent, of \$435 million in gross single-family credit losses.

The application of various credit risk management strategies throughout a loan's life has contributed to continued reductions in credit-related losses. As shown in Table 5, single-family credit-related losses dropped 27 percent in 2000, or \$32 million, compared with 1999. Fannie Mae's credit loss ratio (the ratio of credit-related losses to the average amount of mortgages owned or guaranteed) on its single-family book of business decreased to .7 basis points in 2000 from 1.1 basis points in 1999.

Table 5: Single-Family Credit-Related Losses

	<u>Year Ended December 31,</u>		
	<u>2000</u>	<u>1999</u>	<u>1998</u>
	(Dollars in millions)		
Recoveries, net	\$(127)	\$(126)	\$(57)
Foreclosed property expenses	<u>213</u>	<u>244</u>	<u>306</u>
Credit-related losses	<u>\$ 86</u>	<u>\$ 118</u>	<u>\$249</u>
Credit loss ratio .....	.007%	.011%	.027%

Single-family credit-related losses fell in 2000 compared with 1999 because of a decline in foreclosed property expenses and a slight increase in net recoveries. Foreclosed property expenses decreased \$31 million in 2000, or 13 percent, reflecting a 15 percent decline in the number of acquired properties to 14,351 in 2000 versus 16,806 in 1999, which was primarily attributable to strong economic conditions nationwide. Net recoveries on foreclosed properties increased \$1 million in 2000 because of continued strength in housing markets and higher levels of mortgage insurance coverage on mortgages in foreclosure. Fannie Mae's average credit-related loss per foreclosed single-family property acquisition fell to \$3,800 in 2000 from \$4,800 in 1999.

Fannie Mae tracks various trends in its total book of business to monitor credit risk, including delinquencies, geographical concentrations, loan-to-value ratios, mortgage product mix, and loan age. The risk profile for conventional single-family mortgages in Fannie Mae's portfolio and underlying MBS at the end of 2000 bodes well for credit performance in 2001.

At year-end 2000 Fannie Mae's conventional single-family serious delinquency rate was .45 percent, compared with .48 percent at year-end 1999. This serious delinquency rate is based on the number of single-family mortgages in Fannie Mae's retained portfolio or mortgages underlying MBS for which it retains the primary risk of loss and which are 90 or more days delinquent or in foreclosure. Fannie Mae's serious delinquency rate fell in 2000 as healthy economic conditions lowered delinquency rates in the Northeast and West regions. Table 6 summarizes the single-family serious delinquency rates by region.

Table 6: Single-Family Serious Delinquency Rates

	<u>December 31,</u>		
	<u>2000</u>	<u>1999</u>	<u>1998</u>
Northeast .....	.57%	.67%	.83%
Southeast .....	.49	.50	.57
Midwest .....	.39	.37	.41
Southwest .....	.40	.41	.46
West .....	.38	.46	.61
Total .....	.45	.48	.58

The average current loan-to-value ratio on loans owned or guaranteed by Fannie Mae decreased to 58 percent at year-end 2000 from 60 percent at year-end 1999. The level of equity in homes underlying mortgages is inversely correlated with the incidence and severity of default. Fannie Mae's conventional single-family book of business is predominantly composed of long-term and intermediate-term fixed-rate loans, which have a lower incidence of default than ARMs. At year-end 2000, 93 percent of Fannie Mae's conventional single-family book of business was long-term or intermediate-term fixed-rate loans, which was comparable with year-end 1999.

Table 7 provides a detailed overview of the distribution of Fannie Mae's conventional single-family mortgages by product type and loan-to-value ratios.

**Table 7: Distribution of Conventional Single-Family Loans
by Product Type and Loan-to-Value Ratios**

	Outstanding at December 31,		Percentage of Business Volumes		
	2000	1999	2000	1999	1998
Product:					
Long-term, fixed-rate	74%	72%	73%	76%	77%
Intermediate-term, fixed-rate (1)	19	22	11	19	19
Adjustable-rate	7	6	16	5	4
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>
Original loan-to-value ratio:					
Greater than 90%	14%	14%	17%	15%	10%
81% to 90%	15	15	15	14	12
71% to 80%	41	40	44	42	43
61% to 70%	14	14	11	14	16
Less than 61%	16	17	13	15	19
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>
Average original loan-to-value ratio	75%	74%	77%	75%	74%
Current loan-to-value ratio:					
Greater than 90%	3%	3%			
81% to 90%	6	8			
71% to 80%	17	22			
61% to 70%	23	23			
Less than 61%	51	44			
Total	<u>100%</u>	<u>100%</u>			
Average current loan-to-value ratio	58%	60%			
Average loan amount	\$92,800	\$90,200	\$118,100	\$115,700	\$112,800
(Maximum \$252,700 in 2000)					

(1) Contractual maturities of 20 years or less at purchase for portfolio loans and 15 years or less at issue date for MBS issuances.

Multifamily

Fannie Mae also actively manages credit risk throughout the life of its multifamily loans. There are two primary risks in the underwriting and management of a multifamily loan. First, the underlying property cash flows may be insufficient to service the loan. Second, the proceeds from the sale or refinancing of a property may be insufficient to repay the loan at maturity.

Fannie Mae centralizes responsibility for managing credit risk in the multifamily portfolio to ensure that the aggregate risk is properly identified and managed and to promote consistent application of risk management policies and procedures. Specific areas of responsibility include portfolio credit risk management, lender assessment, counterparty risk evaluation, regular asset management of earning assets, special asset management of troubled investments, and contract compliance monitoring for structured transactions.

Fannie Mae maintains rigorous loan-underwriting guidelines and extensive real estate due diligence examinations for the loans it acquires or guarantees. The loan-underwriting guidelines include specific occupancy rate, loan-to-value, and debt service coverage criteria. The due diligence examinations typically include property condition and property valuation reviews as well as investiga-

tions into the quality of property management. Because of the size of multifamily loans, management generally requires servicers to submit periodic operating information and property condition reviews to monitor the performance of individual loans. Fannie Mae uses this information to evaluate the credit quality of the portfolio, identify potential problem loans, and initiate appropriate loss mitigation activities.

Fannie Mae has dedicated due diligence, portfolio monitoring, and loss mitigation teams to manage credit risk throughout the life of a multifamily loan. The due diligence team specializes in assessing transactions prior to purchase or securitization, particularly with large loans or structured transactions, and performs post-purchase reviews when the underwriting has been delegated to lenders. Under its Delegated Underwriting and Servicing (DUS) product line, Fannie Mae purchases or securitizes mortgages under \$20 million from approved lenders without prior review of the mortgages by Fannie Mae. The portfolio monitoring team performs detailed portfolio loss reviews, addresses borrower and geographic concentration risks, assesses lender qualifications, evaluates counterparty risk, and tracks property performance and contract compliance. Fannie Mae is enhancing its quantitative tools to provide earlier indications of any deterioration in the credit quality of the multifamily portfolio. The loss mitigation team manages troubled assets from default through foreclosure and property disposition, if necessary.

Fannie Mae supplements its multifamily credit risk management efforts with various forms of credit enhancement on the majority of loans purchased or guaranteed. Fannie Mae has shared risk arrangements whereby lenders in its DUS product line bear losses on the first five percent of unpaid principal balance (UPB) and share in remaining losses up to a prescribed limit. On structured transactions, Fannie Mae generally has full or partial recourse to lenders or third parties for loan losses. Letters of credit, investment agreements, or pledged collateral may secure the recourse. Third-party recourse providers for structured and other transactions include government and private mortgage insurers. Table 8 presents the credit risk-sharing profile, by UPB, of multifamily loans in portfolio and underlying MBS at December 31, 2000, 1999, and 1998.

Table 8: Multifamily Risk Profile

	December 31,		
	2000	1999	1998
Fannie Mae risk	13%	12%	11%
Shared risk (1)	59	56	52
Recourse (2)	28	32	37
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>

- (1) Includes loans in which the lender initially bears losses of up to 5 percent of UPB and shares any remaining losses with Fannie Mae up to a prescribed limit.
- (2) Includes loans not included in “shared risk” that have government mortgage insurance, or full or partial recourse to lenders or third parties.

Multifamily credit performance remained strong in 2000. Favorable economic conditions, strong occupancy rates, and high multifamily property values resulted in credit-related losses declining by \$4 million in 2000 from 1999. Foreclosed property acquisitions decreased to three properties in 2000 from seven properties in 1999. At year-end 2000, there were four primary risk multifamily properties in Fannie Mae’s inventory of foreclosed properties, compared with one property at year-end 1999. Management anticipates an increase in multifamily credit losses in 2001 because of the growth of the portfolio in recent years, but expects the multifamily credit loss ratio to remain near 2000 levels. Table 9 provides a detailed breakdown of credit-related losses and the ratio of credit-related losses to average UPB outstanding for multifamily loans in portfolio and underlying MBS.

Table 9: Multifamily Credit-Related Losses

	<u>Year Ended December 31,</u>		
	<u>2000</u>	<u>1999</u>	<u>1998</u>
	(Dollars in millions)		
Charge-offs, net	\$ 2	\$ 4	\$ 8
Foreclosed property expense, net	<u>1</u>	<u>3</u>	<u>5</u>
Credit-related losses.....	<u>\$ 3</u>	<u>\$ 7</u>	<u>\$ 13</u>
Credit loss ratio .....	.007%	.015%	.036%

Multifamily serious delinquencies reached a record year-end low of .05 percent at year-end 2000, down from .12 percent at year-end 1999. Multifamily serious delinquencies are those loans for which Fannie Mae has primary risk of loss (including those with shared risk) and that are 60 days or more delinquent. The multifamily serious delinquency percentage is based on the UPB of these delinquent loans compared with the total amount of multifamily loans in portfolio and underlying MBS for which Fannie Mae is at risk.

Allowance for Losses

Fannie Mae establishes an allowance for losses on mortgages in the retained portfolio and mortgages underlying MBS outstanding. Management sets the allowance for losses at a level it believes is adequate to cover estimated losses inherent in the total book of business. Fannie Mae considers delinquency levels, loss experience, economic conditions in areas of geographic concentration, and mortgage characteristics in establishing the allowance for losses. The allowance for losses is established by recording an expense for the provision for losses. The allowance for losses is subsequently reduced through charge-offs on foreclosed properties, and it is increased through recoveries on foreclosed properties. Senior management reviews the adequacy of the allowance for losses on a quarterly basis.

The allowance for losses was \$809 million at December 31, 2000, compared with \$804 million at December 31, 1999. The allowance for losses declined as a percentage of Fannie Mae's total book of business to .062 percent in 2000 from .067 percent in 1999, primarily because of improved credit performance and favorable economic conditions.

Changes in the allowance for losses for the years 1996-2000 are presented in the following table.

Allowance for Losses

	<u>Total</u> (Dollars in millions)
Balance, January 1, 1996	\$ 795
Provision	195
Net foreclosure losses charged off	<u>(210)</u>
Balance, December 31, 1996	780
Provision	100
Net foreclosure losses charged off	<u>(77)</u>
Balance, December 31, 1997	803
Provision	(50)
Net recoveries	<u>49</u>
Balance, December 31, 1998	802
Provision	(120)
Net recoveries	<u>122</u>
Balance, December 31, 1999	804
Provision	(120)
Net recoveries	<u>125</u>
Balance, December 31, 2000	<u><u>\$ 809</u></u>

Counterparty Risk

Fannie Mae actively manages the counterparty credit risk that arises from several sources, including derivatives, mortgage insurance, recourse, Liquid Investment Portfolio, and mortgage servicing transactions. Fannie Mae's credit risk is that counterparties in these transactions will not fulfill their contractual obligations to make payments due to Fannie Mae. Fannie Mae has a dedicated Counterparty Risk Management team that is responsible for quantifying aggregate counterparty risk exposures across business activities, maintaining a corporate credit policy framework for managing counterparty risk, and directly managing the counterparty risk associated with mortgage insurance companies. Individual business units are responsible for managing the counterparty exposures routinely associated with their business activities. The Counterparty Risk Management team reviews business unit policies, procedures, and approval authorities, and the Credit Committee approves these internal controls.

The primary credit risk posed by Fannie Mae's derivatives transactions is that a counterparty might default on its payments to Fannie Mae, which could result in Fannie Mae having to replace derivatives with a different counterparty at a higher cost. Fannie Mae regularly monitors credit exposures on its derivatives by determining the market value of positions via dealer quotes and internal pricing models. Fannie Mae enters into master agreements that provide for netting of amounts due to Fannie Mae and amounts due to counterparties under those agreements. Fannie Mae's gross off-balance-sheet exposure on derivatives (based upon estimated fair values and taking into account master agreements that allow for netting of payments) was \$.2 billion at December 31, 2000, compared with \$3.9 billion at December 31, 1999.

Derivatives counterparties are subject to master agreements that may require posting of collateral if Fannie Mae is exposed to credit losses exceeding an agreed-upon threshold. The amount of required collateral is based on counterparty credit rating and the level of credit exposure. Fannie Mae generally requires overcollateralization from counterparties whose credit ratings have dropped below predetermined levels. Fannie Mae held \$70 million of collateral through custodians for derivative instruments at December 31, 2000.

Fannie Mae also manages derivatives counterparty credit risk by contracting only with experienced counterparties that have high credit ratings. At year-end 2000, over 99 percent of both the notional amount of Fannie Mae's outstanding derivatives transactions and Fannie Mae's gross off-balance-sheet derivatives exposure were with counterparties rated A or better by Standard & Poor's. Fannie Mae diversifies its derivative instruments among counterparties to lower credit risk concentrations. At year-end 2000, nine counterparties represented approximately 86 percent of the total notional amount of outstanding derivatives transactions, and each had a credit rating of A or better. At year-end 2000, five counterparties comprised approximately 99 percent of gross off-balance-sheet exposure on derivatives, and each had a credit rating of A or better.

The primary credit risk presented by Fannie Mae's mortgage insurance counterparties is that they will be unable to meet their contractual obligations to compensate Fannie Mae for credit losses on insured mortgages. Before approving a mortgage insurance company, Fannie Mae conducts a comprehensive counterparty analysis, which generally includes a review of the mortgage insurer's business plan, insurance portfolio characteristics, master insurance policies, reinsurance treaties, and ratings on ability to pay claims. Fannie Mae monitors approved insurers through a reporting and analysis process performed on a quarterly basis. At year-end 2000, Fannie Mae was the beneficiary on primary mortgage insurance coverage of \$302 billion for single-family loans in portfolio or underlying MBS. Seven mortgage insurance companies, all rated AA or higher by Standard & Poor's, provided 98 percent of the total coverage.

The primary credit risk associated with recourse transactions is that lenders will be unable to fulfill their obligations to absorb losses on mortgage loans that default. Fannie Mae sometimes retains recourse to lenders for loan losses on mortgages it purchases or mortgages underlying guaranteed MBS. Fannie Mae held an estimated \$40 billion in total recourse to lenders on single-family loans at year-end 2000, and 62 percent of the recourse providers were rated investment grade or higher (a rating of BBB-/Baa- or higher by Standard & Poor's and Moody's Investor Service, respectively). The recourse providers that were not investment grade or were not rated constituted 38 percent of Fannie Mae's single-family recourse exposure. Fannie Mae can mitigate the risk associated with recourse transactions through various means, including requiring lenders to pledge collateral to secure their obligations. In addition, Fannie Mae can protect itself against losses from a lender's nonperformance by terminating a lender's contractual status as a Fannie Mae seller/servicer, selling the lender's rights to service Fannie Mae loans, and retaining sale proceeds.

The primary credit risk associated with the Liquid Investment Portfolio is that counterparties will not repay Fannie Mae in accordance with contractual terms. The level of credit risk in the portfolio is low because the liquidity investments are primarily high-quality short-term investments, such as asset-backed securities, commercial paper, and federal funds. The majority of asset-backed securities in the Liquid Investment Portfolio are rated AAA by Standard & Poor's. Unsecured investments in the portfolio are generally rated A or higher by Standard & Poor's.

The primary credit risk associated with mortgage servicers is that they will not fulfill their contractual servicing obligations. On behalf of Fannie Mae, mortgage servicers collect mortgage and escrow payments from borrowers, pay taxes and insurance costs from escrow accounts, monitor and report delinquencies, and perform other required activities. A servicing contract breach could result in credit losses for Fannie Mae, or Fannie Mae could incur the cost of finding a replacement servicer. Fannie Mae mitigates this risk by requiring mortgage servicers to maintain a minimum servicing fee rate that Fannie Mae could assume or transfer to compensate a replacement servicer in the event of a servicing contract breach. Fannie Mae also manages this risk by requiring servicers to follow specific servicing guidelines and by monitoring each servicer's performance using loan-level data. Fannie Mae conducts on-site reviews of compliance with servicing guidelines and mortgage servicing performance. Fannie Mae also works on-site with nearly all of its major servicers to facilitate loan loss mitigation efforts and improve the default management process. In addition, Fannie Mae reviews quarterly financial information on servicers. At year-end 2000, Fannie Mae's 25 largest mortgage servicers serviced 80 percent of its single-family book of business.

Additional information on counterparty credit risk is presented in the Notes to Financial Statements under Note 13, “Financial Instruments with Off-Balance-Sheet Risk” and Note 14, “Concentrations of Credit Risk.”

Operations Risk Management

Operations risk is the risk of potential loss resulting from a breakdown in established controls and procedures, examples of which include circumvention of internal controls, fraud, human error, and systems malfunction or failure. Fannie Mae has established extensive policies and procedures to decrease the potential likelihood of such occurrences. Fannie Mae’s internal Office of Auditing tests the adequacy of and adherence to internal controls and established policies and procedures. Financial system data are regularly reconciled to source documents to ensure the accuracy of financial system outputs. In addition, Fannie Mae has a comprehensive disaster recovery plan that is designed to restore critical operations with minimal interruption in the event of a natural disaster.

The use of financial forecast models is another potential operations risk. To mitigate the risk associated with the use of financial models, Fannie Mae regularly reconciles forecasted results to actual results and recalibrates models for the differences.

Fannie Mae evaluates key performance indicators for elements of operations risk to monitor trends and identify early warning signals. Each key performance indicator is based on clearly defined and quantifiable performance thresholds. Senior managers are responsible for monitoring key performance indicators, addressing the monthly results, and taking corrective actions as necessary.

Balance Sheet Analysis

Fannie Mae’s primary balance sheet activities are purchasing mortgages and other investments with proceeds from debt issuances and from repayments of mortgages and other investments. Fannie Mae’s liquidity and capital resources are critical to its activities and its regulatory capital requirements. The following analysis describes trends in these aspects of Fannie Mae’s business activities.

Mortgage Portfolio

Fannie Mae’s retained mortgage portfolio, net, grew 16 percent to \$607 billion at December 31, 2000 from \$523 billion at December 31, 1999. Retained mortgage portfolio growth was relatively modest in the first half of the year as higher mortgage interest rates and strong mortgage portfolio growth at depository institutions dampened secondary market activity. Retained mortgage portfolio growth accelerated in the second half of the year as lower interest rates, a falling adjustable-rate mortgage share of originations, and considerable selling of mortgages by depository institutions accelerated secondary market activity and widened mortgage-to-debt spreads. Management expects retained mortgage portfolio growth to be in the high teens in 2001.

Additional information on mortgage portfolio composition is presented in the Notes to Financial Statements under Note 2, “Mortgage Portfolio, Net.”

The average yield on the retained mortgage portfolio increased to 7.16 percent during 2000 from 7.04 percent during 1999. The increase in yield resulted largely from the general rise in mortgage rates on loans sold into the secondary market and a decline in the annual rate of liquidations. The liquidation rate on mortgages in portfolio (excluding sales) fell to 10 percent in 2000 from 17 percent in 1999. Total mortgage liquidations decreased to \$57 billion in 2000 from \$80 billion in 1999 due largely to higher mortgage interest rates in the first half of the year, which decreased the level of mortgage prepayments. Management expects the average yield on the retained portfolio in 2001 to decline slightly from the level attained in 2000.

Table 10 summarizes mortgage portfolio activity and average yields from 1998 through 2000.

Table 10: Mortgage Portfolio Activity

	Purchases			Sales			Repayments (1)		
	2000	1999	1998	2000	1999	1998	2000	1999	1998
	(Dollars in millions)								
Single-family:									
Government insured or guaranteed	\$ 6,940	\$ 23,575	\$ 6,016	\$ 521	\$ 360	\$ —	\$ 3,423	\$ 4,092	\$ 3,729
Conventional:									
Long-term, fixed-rate	113,444	146,679	147,615	9,219	5,779	1,383	35,208	52,707	60,718
Intermediate-term, fixed-rate	11,271	15,292	28,703	599	9	1	13,073	17,825	18,713
Adjustable-rate	17,683	6,073	3,507	374	—	—	4,293	3,829	2,965
Second	336	23	22	—	—	—	32	53	84
Total single-family	149,674	191,642	185,863	10,713	6,148	1,384	56,029	78,506	86,209
Multifamily	4,557	3,568	2,585	269	—	409	1,204	1,244	2,658
Total	<u>\$154,231</u>	<u>\$195,210</u>	<u>\$188,448</u>	<u>\$10,982</u>	<u>\$6,148</u>	<u>\$1,793</u>	<u>\$57,233</u>	<u>\$79,750</u>	<u>\$88,867</u>
Average net yield	7.62%	6.88%	6.61%				7.18%	7.39%	7.66%
Repayments as a percentage of average mortgage portfolio							10.3	16.9	25.0

(1) Includes mortgage loan prepayments, scheduled amortization, and foreclosures.

Investments

Fannie Mae’s investments increased 38 percent to \$55 billion at December 31, 2000 from \$40 billion at December 31, 1999. Fannie Mae’s Liquid Investment Portfolio comprises the bulk of its investments, and it totaled \$52 billion at year-end 2000. The Liquid Investment Portfolio primarily consists of high-quality short-term investments in nonmortgage assets, such as asset-backed securities, commercial paper, and federal funds. The Liquid Investment Portfolio serves as a source of liquidity and an investment vehicle for Fannie Mae’s surplus capital.

In 2000 investments grew significantly because of an increase in Fannie Mae’s surplus capital and a more normal mortgage portfolio growth rate compared to last year. The average yield on investments rose to 6.60 percent in 2000 from 5.52 percent in 1999 because of an increase in average short-term interest rates.

Additional information on the Liquid Investment Portfolio is presented in MD&A in the “Counterparty Risk” section under “Risk Management—Credit Risk Management” and the Notes to Financial Statements under Note 1, “Summary of Significant Accounting Policies” and Note 4, “Investments.”

Financing Activities

Fannie Mae’s total debt outstanding increased 17 percent to \$643 billion at year-end 2000 from \$548 billion at year-end 1999. Fannie Mae’s average cost of debt increased to 6.35 percent in 2000 from 6.11 percent in 1999 because of higher interest rates. Effective long-term debt decreased to 85 percent of total debt outstanding at December 31, 2000, from 87 percent at year-end 1999, taking into consideration the effect of derivative instruments on the effective maturity of long-term and short-term debt. Fannie Mae’s effective long-term debt as a percentage of its retained mortgage portfolio decreased to 90 percent at year-end 2000 from 91 percent at year-end 1999. The weighted-average maturity of effective long-term, fixed-rate debt outstanding at December 31, 2000 was 79 months versus 80 months at December 31, 1999. Interest rate swaps effectively lengthened the final maturity of Fannie Mae’s liabilities by 24 months at December 31, 2000 and 28 months at December 31, 1999.

Table 11 provides a summary of debt issuances and repayments during 2000 compared with the previous two years as well as the average cost of debt outstanding at year-end.

Table 11: Short-Term and Long-Term Debt Activity

	<u>2000</u>	<u>1999</u>	<u>1998</u>
	(Dollars in millions)		
Issued during the year:			
Short-term(1):			
Amount	\$1,143,131	\$1,136,001	\$695,495
Average cost	6.27%	5.17%	5.42%
Long-term(1):			
Amount	\$ 110,215	\$ 139,020	\$147,430
Average cost	6.92%	6.07%	5.81%
Repaid during the year:			
Short-term(1):			
Amount	\$1,106,956	\$1,125,748	\$657,308
Average cost	6.15%	5.10%	5.51%
Long-term(1):			
Amount	\$ 50,335	\$ 61,790	\$ 94,728
Average cost	6.33%	6.51%	6.40%
Outstanding at year-end:			
Due within one year:			
Net amount	\$ 280,322	\$ 226,582	\$205,413
Average cost(2)	6.40%	5.80%	5.33%
Due after one year:			
Net amount	\$ 362,360	\$ 321,037	\$254,878
Average cost(2)	6.46%	6.22%	6.25%
Total debt:			
Net amount	\$ 642,682	\$ 547,619	\$460,291
Average cost(3)	6.47%	6.18%	6.10%

(1) "Short-term" refers to the face amount of debt issued with an original term of one year or less. "Long-term" is the face amount of debt issued with an original term greater than one year.

(2) Average cost includes the amortization of premiums, discounts, issuance costs, hedging results, and the effects of currency and debt swaps.

(3) Average cost includes the amortization of premiums, discounts, issuance costs, hedging results, and the effects of currency, debt, and interest rate swaps.

Fannie Mae's Benchmark SecuritiesSM program continued to grow in 2000. The Benchmark Securities program encompasses large issues of noncallable and callable debt designed to provide liquidity and performance to investors while reducing Fannie Mae's cost of debt. The Benchmark Securities program has served to consolidate much of Fannie Mae's debt issuances from a large number of small unscheduled issues to a smaller number of larger, more liquid scheduled issues.

During 2000, Fannie Mae issued Benchmark Notes[®] and Benchmark BondsSM with specific maturities in each month of the year and began building and maintaining a noncallable Benchmark yield curve. Benchmark BillsSM became Fannie Mae's weekly source for all of its three-month and six-month discount debt securities for the entire year in 2000. In October 2000, Fannie Mae introduced the one-year Benchmark Bill, which will be regularly issued on a bi-weekly schedule. Fannie Mae

issued a total of \$413 billion in debt under the Benchmark Securities program in 2000, with maturities ranging from 3 months to 30 years, compared with \$114 billion in 1999. The growth of the Benchmark Bills program drove most of the increase in the Benchmark Securities program as issuances rose to \$334 billion in 2000 versus \$42 billion in 1999.

As described in the MD&A section entitled “Risk Management—Interest Rate Risk Management,” Fannie Mae strives to match the durations of its mortgages with the durations of liabilities funding those mortgages. Fannie Mae uses debt instruments with varied maturities and embedded option characteristics, or hedges debt with interest rate swaps, caps, and swaptions to match the durations of its mortgages. The total amount of option-embedded debt outstanding as a percentage of the retained mortgage portfolio declined slightly to 46 percent at year-end 2000 from 47 percent at year-end 1999. Table 12 presents option-embedded debt instruments as a percentage of mortgage purchases and the retained mortgage portfolio for the past three years. Option-embedded debt instruments include derivative instruments.

Table 12: Option-Embedded Debt Instruments

	<u>2000</u>	<u>1999</u>	<u>1998</u>
	(Dollars in billions)		
Issued during the year	\$ 65	\$114	\$113
Percentage of total mortgage purchases	42%	58%	60%
Outstanding at year-end	\$280	\$247	\$174
Percentage of total net mortgage portfolio	46%	47%	42%

Fannie Mae employs derivative instruments as hedges of debt to increase the flexibility of its funding alternatives. Derivative instruments often can provide the specific cash flows or characteristics that the portfolio requires at a lower cost than the standard debt market. Fannie Mae does not speculate using derivatives and does not engage in derivatives trading.

Fannie Mae primarily uses four types of derivative instruments: swaps, basis swaps, swaptions, and interest rate caps. Swaps provide for the exchange of fixed and variable interest payments based on contractual notional principal amounts. These may include callable swaps, which give counterparties or Fannie Mae the right to terminate interest rate swaps before their stated maturities, and foreign currency swaps, in which Fannie Mae and counterparties exchange payments in different types of currencies. Basis swaps provide for the exchange of variable payments that have maturities similar to hedged debt, but the payments are based on different interest rate indices. Swaptions give Fannie Mae the option to enter into swaps at a future date, thereby mirroring the economic effect of callable debt. Interest rate caps provide ceilings on the interest rates of variable-rate debt.

Table 13 summarizes Fannie Mae’s derivative activity for the years ended December 31, 2000 and 1999. Table 13 includes the expected maturities and weighted-average interest rates to be received and paid on these derivative instruments. Fannie Mae’s interest rate swaps had a weighted-average term of 106 months at December 31, 2000 versus 112 months at December 31, 1999.

Table 13: Derivative Activity and Maturity Data (1)

	Generic-Pay Fixed/ Receive Variable Swaps (2)			Pay Variable/ Receive Fixed Swaps	Basis Swaps	Caps and Swaptions	Total
	Notional	Pay Rate (3)	Receive Rate (3)				
(Dollars in millions)							
Balance on January 1, 1999	\$ 96,014	6.53%	5.30%	\$29,470	\$16,919	\$27,165	\$169,568
Additions	55,532	6.76	5.52	21,859	19,445	25,700	122,536
Maturities	<u>12,142</u>	<u>6.99</u>	<u>4.99</u>	<u>19,707</u>	<u>16,820</u>	<u>4,750</u>	<u>53,419</u>
Balance on December 31, 1999	139,404	6.55	6.03	31,622	19,544	48,115	238,685
Additions	37,170	6.83	6.74	48,482	14,600	42,163	142,415
Maturities	<u>22,837</u>	<u>5.75</u>	<u>6.63</u>	<u>20,930</u>	<u>19,585</u>	<u>7,750</u>	<u>71,102</u>
Balance on December 31, 2000	<u>\$153,737</u>	<u>6.74%</u>	<u>6.79%</u>	<u>\$59,174</u>	<u>\$14,559</u>	<u>\$82,528</u>	<u>\$309,998</u>
Future Maturities (4)							
2001	\$ 12,525	6.11%	6.74%	\$42,816	\$13,075	\$11,520	\$ 79,936
2002	13,045	6.23	6.64	6,789	904	15,850	36,588
2003	9,525	6.16	6.74	1,431	—	15,908	26,864
2004	10,720	7.19	6.81	350	100	5,950	17,120
2005	11,075	6.99	6.83	650	—	5,200	16,925
Thereafter	<u>96,847</u>	<u>6.86</u>	<u>6.82</u>	<u>7,138</u>	<u>480</u>	<u>28,100</u>	<u>132,565</u>
Total	<u>\$153,737</u>	<u>6.74%</u>	<u>6.79%</u>	<u>\$59,174</u>	<u>\$14,559</u>	<u>\$82,528</u>	<u>\$309,998</u>

- (1) Dollars represent notional amounts that only indicate the amount on which payments are being calculated and do not represent the amount at risk of loss.
- (2) Included in the notional amounts are callable swaps and swaptions of \$70 billion and \$47 billion with weighted-average pay rates of 6.63 percent and 5.08 percent and weighted-average receive rates of 6.83 percent and 6.06 percent at December 31, 2000 and December 31, 1999, respectively.
- (3) The weighted-average interest rate payable and receivable is as of the date indicated. The interest rates of the swaps may be variable-rate, so these rates may change as prevailing interest rates change.
- (4) Based on stated maturities. Assumes that variable interest rates remain constant at December 31, 2000 levels.

Fannie Mae also hedges against fluctuations in interest rates on planned debt issuances with derivative instruments that simulate the short sale of U.S. Treasury and agency securities, interest rate swaps, and deferred rate-setting agreements. Gains and losses on these instruments are deferred and reflected as basis adjustments to the cost of the debt when issued. The hedging of anticipated debt issuances enables Fannie Mae to maintain an orderly and cost-effective debt issuance schedule so it can fund daily loan purchase commitments without significantly increasing its interest rate risk or exposure to changes in the spread of its funding costs versus benchmark interest rates.

Additional information on interest rate swaps and other off-balance-sheet financial instruments are presented in MD&A under “Risk Management” and in the Notes to Financial Statements under Note 13, “Financial Instruments with Off-Balance-Sheet Risk” and Note 15, “Disclosures of Fair Value of Financial Instruments.”

Liquidity and Capital Resources

Fannie Mae’s statutory mission requires that it provide ongoing assistance to the secondary market for mortgages. Fannie Mae therefore must continually raise funds to support its mortgage purchase activity. The capital markets have traditionally treated Fannie Mae’s obligations as “federal agency” debt even though the U.S. government does not guarantee, directly or indirectly, Fannie Mae’s debt. As a result, Fannie Mae has had ready access to funding at relatively favorable spreads.

Fannie Mae's primary sources of cash are issuances of debt obligations, mortgage repayments, interest income, and MBS guaranty fees. In addition, Fannie Mae had cash and cash equivalents and short-term investments totaling \$56 billion at year-end 2000. Primary uses of cash include the purchase of mortgages and other securities, repayment of debt, interest payments, administrative expenses, and taxes.

At December 31, 2000, Fannie Mae had \$16 billion in outstanding mandatory commitments to purchase mortgages and \$2 billion in outstanding optional commitments for delivery in 2001. At December 31, 1999, Fannie Mae had \$7 billion in outstanding mandatory commitments to purchase mortgages and \$2 billion in outstanding optional commitments for delivery in 2000.

Fannie Mae's capital base (stockholders' equity plus the general allowance for losses) grew to \$21.6 billion at year-end 2000, compared with \$18.4 billion at year-end 1999. At year-end 2000, 999 million shares of common stock were outstanding, net of shares held in treasury. Common stock issuances totaled 5 million shares for employee and other stock compensation plans in 2000. Fannie Mae raised \$978 million in additional equity in 2000 by issuing variable-rate non-cumulative preferred stock twice during the year. In March 2000, Fannie Mae issued 13.8 million shares of Series F preferred stock with an initial rate of 6.30 percent at a stated value of \$50 per share. In August 2000, Fannie Mae issued 5.75 million shares of Series G preferred stock with an initial rate of 6.02 percent at a stated value of \$50 per share. The initial rate resets every two years for Series F and Series G, and each of these series is callable every two years.

In January 2001 the Board of Directors approved a quarterly common stock dividend for 2001 of \$.30 per common share. In 2000 the quarterly dividend rate was \$.28 per common share. The Board of Directors also approved preferred stock dividends for the period commencing December 31, 2000, up to, but excluding, March 31, 2001 as identified in Table 14.

Table 14: Preferred Stock Dividends

<u>Preferred Stock Series</u>	<u>Dividend per Share</u>
Series A(1)	\$.80125
Series B .....	.81250
Series C .....	.80625
Series D .....	.65625
Series E .....	.63750
Series F .....	.78690
Series G .....	.77880

(1) Fannie Mae redeemed all of the outstanding shares of its 6.41 percent Series A preferred stock on March 1, 2001 at \$50.53 per share. The redemption price included dividends of \$.53417 per share for the period commencing December 31, 2000, up to, but excluding, March 1, 2001.

Fannie Mae continued its capital restructuring program in 2000, repurchasing 25 million shares of common stock. In 1999 Fannie Mae repurchased 10 million shares of common stock. The stock repurchases were made pursuant to the Board's approval to repurchase up to an additional 6 percent of outstanding common shares as of December 27, 1995 (adjusted for a stock split) and to repurchase shares to offset the dilutive effect of common shares issued in conjunction with various stock compensation plans.

Fannie Mae's Portfolios and Capital Committee, chaired by the Chief Financial Officer, determines interest rate risk and credit risk pricing thresholds, formulates corporate hedging strategies, and ensures compliance with economic and regulatory risk-based capital requirements. Fannie Mae assesses capital adequacy using an internally developed stress test methodology. The stress test model

calculates the amount of capital required under different economic scenarios. Fannie Mae uses this model to estimate the potential amount of capital needed to carry out the company's mission during a period of economic distress. Based on the results of this model and other factors, Fannie Mae makes decisions on the risk structure of its business.

Regulatory Environment

Fannie Mae is subject to capital adequacy standards established by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (1992 Act) and continuous examination by the Office of Federal Housing Enterprise Oversight (OFHEO), which was also established by the 1992 Act. The capital adequacy standards require that Fannie Mae's core capital equal or exceed a minimum capital standard and a critical capital standard. Table 15 shows Fannie Mae's core capital at year-end 2000 and 1999 compared with the requirements.

Table 15: Capital Requirements

	December 31,	
	2000	1999
	(Dollars in millions)	
Core capital(1)	\$20,827	\$17,876
Required minimum capital(2)	<u>20,294</u>	<u>17,770</u>
Excess of core capital over minimum capital	<u>\$ 533</u>	<u>\$ 106</u>
Required critical capital(3)	\$10,337	\$ 9,127
Excess of core capital over required critical capital	10,490	8,748

- (1) The sum of (a) the stated value of outstanding common stock; (b) the stated value of outstanding noncumulative perpetual preferred stock; (c) paid-in capital; and (d) retained earnings.
- (2) The sum of (a) 2.50 percent of on-balance-sheet assets; (b) .45 percent of outstanding MBS; and (c) .45 percent of other off-balance-sheet obligations, which may be adjusted by the Director of OFHEO under certain circumstances (See 12 CFR 1750.4 for existing adjustments made by the Director of OFHEO).
- (3) The sum of (a) 1.25 percent of on-balance-sheet assets; (b) .25 percent of outstanding MBS; and (c) .25 percent of other off-balance-sheet obligations, which may be adjusted by the Director of OFHEO under certain circumstances.

The Director of OFHEO has proposed a risk-based capital standard as required by the 1992 Act. The risk-based capital standard includes capital requirements for credit risk, interest rate risk, and management and operations risk. To meet the proposed capital standard, Fannie Mae would have to hold capital based on the occurrence of extreme credit and interest rate conditions over a ten-year horizon, plus an additional 30 percent of that amount for management and operations risk.

OFHEO released Part I of the proposed risk-based capital regulations for public comment in 1996. Part I proposed benchmarks for credit stress testing and specified the housing price index that would be used in connection with this standard. Part II of the proposed risk-based capital regulations was released for public comment in March 1999, and it proposed the use of a specific model to assess capital requirements for credit risk and interest rate risk. Fannie Mae submitted comments on both parts of the risk-based capital proposal to OFHEO. The 1992 Act provides that the final regulation will be enforceable one year after issuance of a final regulation.

In March 2000, U.S. Representative Richard Baker (R-LA) introduced a bill, H.R. 3703, that proposed to consolidate the regulation of Fannie Mae, Freddie Mac, and the Federal Home Loan

Banks under a new five-member regulatory board. The bill proposed other changes to the regulation of Fannie Mae and Freddie Mac and was the subject of several hearings by a House Subcommittee. The bill was never brought to a vote in the Subcommittee.

In October 2000, Fannie Mae and Freddie Mac announced, with Rep. Baker and a group of bipartisan members of Congress, the adoption of a series of voluntary measures to enhance disclosure, capital, and market discipline. Fannie Mae began implementing and disclosing these measures during the first quarter of 2001. The two companies committed to the following measures:

- Issue publicly traded, externally rated subordinated debt on at least a semi-annual basis such that the sum of core capital and outstanding subordinated debt for each company will equal or exceed four percent of on-balance sheet assets following a three-year phase in period. This is intended to promote market discipline and supplement capital to further strengthen the companies' financial positions. Fannie Mae intends to issue Subordinated Benchmark Notes on a quarterly basis during 2001 and on at least a semi-annual basis thereafter. In February 2001, Fannie Mae issued \$1.5 billion of 10-year Subordinated Benchmark Notes. The Subordinated Benchmark Notes received ratings of Aa2 from Moody's Investors Service and AA- from Standard & Poor's.
- Maintain more than three months worth of liquidity, assuming no access to the new issue debt markets, to reduce the possibility that the companies' operations could be disrupted during a significant financial crisis. The companies also committed to maintain at least five percent of on-balance sheet assets in a liquid, marketable portfolio of nonmortgage securities and to maintain additional highly liquid securities in unencumbered form to facilitate liquidity. On March 12, 2001, Fannie Mae announced that it had a contingency plan in place to ensure that it could meet its obligations for three months without access to the debt markets. In addition, Fannie Mae reported that liquid investments were 8.1 percent of on-balance sheet assets at year-end 2000.
- Implement an interim risk-based capital stress test on a quarterly basis using parameters contained in the 1992 Act, and publicly disclose the outcome and parameters of this test, pending OFHEO's release of permanent risk-based capital regulations.
- Publicly disclose the results of interest rate risk sensitivity analyses on a monthly basis.
- Publicly disclose the results of credit risk sensitivity analyses on a quarterly basis.
- Obtain and publicly disclose a "risk to the government" or independent financial strength rating from a nationally recognized statistical rating organization on an annual basis. On February 27, 2001, Fannie Mae received an AA- rating from Standard & Poor's. This rating is based on Standard & Poor's evaluation of Fannie Mae's underlying credit quality, without assuming direct support from the federal government. Fannie Mae announced that Standard & Poor's will evaluate the rating on a continuous basis, and Standard & Poor's will publicly report if the company's financial strength changes.

Mortgage-Backed Securities

Total MBS outstanding grew 10 percent to \$1.058 trillion at year-end 2000 from \$961 billion at year-end 1999, which was comparable to the growth in the overall mortgage market. MBS issuances totaled \$212 billion in 2000, down from \$301 billion in 1999. MBS liquidations slowed to \$115 billion in 2000, compared with \$174 billion in 1999. The reductions in MBS issuances and liquidations in 2000 were attributable to the increase in mortgage interest rates during the first half of the year.

Fannie Mae issues MBS that are backed by mortgage loans purchased from a single lender or from multiple lenders, or that are transferred from Fannie Mae's mortgage portfolio. Single-lender MBS are issued through lender swap transactions whereby a lender exchanges pools of mortgages for MBS. Multiple-lender MBS allow several lenders to pool mortgages and receive, in return, MBS

(called Fannie Majors) representing a proportionate share of a larger pool. Lenders may retain the MBS or sell them to other investors. MBS are not assets of Fannie Mae except when acquired for investment purposes, nor are the MBS recorded as liabilities. In some instances Fannie Mae buys mortgage loans and concurrently enters into a forward sale commitment. These loans are designated as held for sale when acquired and sold from the portfolio as MBS.

Sellers of pools of mortgage loans may retain or transfer to one or more third parties the primary default risk on loans constituting the MBS pools, or they may elect to transfer this credit risk to Fannie Mae. Fannie Mae receives a guaranty fee for assuming the credit risk and guaranteeing timely payment of principal and interest to MBS investors. The guaranty fee paid by the lender varies, depending on the risk profile of the loans securitized as well as the level of credit risk assumed by Fannie Mae. Fannie Mae is ultimately responsible for guaranteeing timely payment of principal and interest to MBS investors whether or not Fannie Mae shares primary default risk on loans underlying MBS. Fannie Mae accrues a liability on its balance sheet for its guarantee obligation based on the probability that mortgages underlying MBS will not perform according to contractual terms and the level of credit risk it has assumed.

Table 16 summarizes the risk distribution for MBS issued and outstanding for the years ended December 31, 2000, 1999, and 1998.

Table 16: MBS Risk Distribution

	Issued (1)			Outstanding (1)		
	Lender or Shared Risk	Fannie Mae Risk	Total	Lender or Shared Risk (2)	Fannie Mae Risk	Total (3)
	(Dollars in millions)					
2000	\$27,295	\$184,367	\$211,662	\$222,595	\$835,155	\$1,057,750
1999	75,187	225,502	300,689	209,190	751,693	960,883
1998	90,694	235,454	326,148	160,223	674,295	834,518

- (1) Based on primary default risk category. MBS outstanding includes MBS that have been pooled to back Fannie Megas, SMBS, or REMICs.
- (2) Included in lender risk are \$173 billion, \$163 billion, and \$123 billion at December 31, 2000, 1999, and 1998, respectively, on which the lender or a third party has agreed to bear default risk limited to a certain portion or percentage of the loans delivered and, in some cases, on which the lender has pledged collateral to secure that obligation. Fannie Mae is ultimately responsible for bearing default risk if the lender or third party fails to fulfill its obligation.
- (3) Included are \$351 billion, \$282 billion, and \$197 billion at December 31, 2000, 1999, and 1998, respectively, of MBS in Fannie Mae's portfolio.

Fannie Mae also issues Real Estate Mortgage Investment Conduits (REMICs) backed by MBS, Stripped MBS (SMBS), Government National Mortgage Association (Ginnie Mae) mortgage-backed securities, other REMIC securities, or whole loans. REMICs backed by MBS or SMBS provide an additional source of fee income from issuances that do not subject Fannie Mae to added credit risk. In 2000, REMIC issuances were \$34 billion, compared with \$51 billion in 1999. Fannie Mae REMIC issuances declined along with the rest of the REMIC market in 2000. REMIC market volumes fell primarily because of a flatter yield curve. In addition, higher interest rates contributed to fewer mortgage-backed securities issuances and decreased collateral available for REMICs. The outstanding balance of REMICs at December 31, 2000 was \$292 billion, compared with \$294 billion at December 31, 1999. REMICs are not assets of Fannie Mae except when acquired for investment purposes, nor are the REMICs recorded as liabilities.

Housing Goals

The 1992 Act gives the HUD Secretary authority to establish low- and moderate-income, underserved areas, and special affordable housing goals for Fannie Mae. Table 17 shows that Fannie Mae exceeded its goals for 2000 and 1999.

Table 17: Housing Goals

	Year Ended December 31,			
	2000		1999	
	Goal (1)	Result	Goal (1)	Result
	(Dollars in billions)			
Low- and moderate-income housing	42.0%	49.5%	42.0%	45.9%
Underserved areas	24.0	31.0	24.0	26.7
Special affordable housing	14.0	22.3	14.0	18.7
Targeted multifamily	\$ 1.3	\$ 3.8	\$ 1.3	\$ 4.1

(1) Goals are expressed as a percentage of Fannie Mae's conventional mortgage business during the period, except for the targeted multifamily goal.

In October 2000, HUD issued a final rule with new housing goals that are effective in 2001 and represent significant increases over current goals. The low- and moderate-income housing goal increased to 50 percent from 42 percent. The underserved areas housing goal increased to 31 percent from 24 percent. The special affordable housing goal, a more targeted measure, increased to 20 percent from 14 percent. The targeted multifamily subgoal more than doubled to \$2.85 billion from \$1.30 billion. The final rule also includes certain provisions that reduce penalties for missing data, increase recognition for special products serving small but needy markets, and provide incentive points for serving small multifamily and owner-occupied rental housing. The new goals represent a significant increase above Fannie Mae's historic level of performance, yet management has made a commitment to meet these goals in 2001.

American Dream Commitment

The American Dream Commitment, announced by Fannie Mae on March 15, 2000, is a six-point plan to invest \$2 trillion and serve 18 million households over 10 years to close homeownership gaps, strengthen communities and stabilize neighborhoods, and fight discrimination and unfair practices in the mortgage marketplace.

The American Dream Commitment is Fannie Mae's next affordable housing challenge after surpassing its Trillion Dollar Commitment to serve 10 million households by the end of 2000. The Trillion Dollar Commitment was a significant targeted housing finance commitment that served families with incomes below the median for their areas, minorities and new immigrants, families who live in central cities and distressed communities, and people with special housing needs. Fannie Mae surpassed the commitment to serve 10 million households in August 1999 and exceeded the \$1 trillion financing goal in the spring of 2000, both well before the year-end 2000 goal.

New Accounting Standards

Financial Accounting Standard No. 133 (FAS 133), *Accounting for Derivative Instruments and Hedging Activities*, as amended by FAS 138, was effective for Fannie Mae beginning January 1, 2001. FAS 133 requires that all derivatives be recognized as either assets or liabilities on the balance sheet at their fair value. Subject to certain qualifying conditions, a derivative may be designated as either a hedge of the fair value of a fixed-rate instrument (fair value hedge) or a hedge of the cash flows of a variable-rate instrument or anticipated transaction (cash flow hedge). For a derivative qualifying as a fair value hedge, fair value gains or losses on the derivative would be reported in earnings along with

the fair value losses or gains on the hedged item attributable to the risk being hedged. For a derivative qualifying as a cash flow hedge, fair value gains or losses on the derivative associated with the risk being hedged would be reported in a separate component of stockholders' equity (other comprehensive income) and then amortized into earnings in the period(s) in which the hedged item affects income. For a derivative not qualifying as a hedge, or components of a derivative that are excluded from any hedge effectiveness assessment, fair value gains and losses on the derivative would be reported in earnings. On January 1, 2001, the cumulative after-tax effect of the adoption of FAS 133 was \$168 million of income and a \$3.9 billion loss in the other comprehensive income component of stockholders' equity.

In September 2000, the Financial Accounting Standards Board issued Financial Accounting Standard No. 140 (FAS 140), a replacement of FAS 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*. The collateral and disclosure provisions of FAS 140 were effective for Fannie Mae for the fiscal year ending December 31, 2000. The provisions governing transfers and servicing of financial assets and extinguishment of liabilities become effective April 1, 2001. In management's opinion, these provisions of FAS 140 will not have a material impact on Fannie Mae.

Comparison of 1999 with 1998

The following discussion and analysis compares Fannie Mae's results of operations for the years ended December 31, 1999 and 1998.

Results of Operations

Net income increased 14 percent to \$3.912 billion in 1999 from \$3.418 billion in 1998. Diluted earnings per common share rose 15 percent to \$3.72, up from \$3.23 in 1998.

Total taxable-equivalent revenues grew 11 percent to \$6.975 billion in 1999 from \$6.272 billion in 1998. The growth was primarily attributable to an increase in net interest income.

Net interest income increased \$784 million, or 19 percent, to \$4.894 billion in 1999 because of a 33 percent increase in the average mortgage portfolio balance, which more than offset a 2 basis point decrease in the average net interest margin. Retained mortgage portfolio growth was attributable to strong mortgage origination volumes in the primary market during the first half of 1999.

Guaranty fee income increased \$53 million, or 4 percent, to \$1.282 billion in 1999 from \$1.229 billion in 1998. The increase in guaranty fee income primarily resulted from a 9 percent increase in average net Fannie Mae MBS outstanding, which more than offset a .9 basis point decline in the average effective guaranty fee rate.

Fee and other income (expense) declined \$84 million to income of \$191 million in 1999 from income of \$275 million in 1998. The decrease resulted largely from a decline in multifamily fees and an increase in net operating losses from certain tax-advantaged investments, which more than offset an increase in technology fees.

Credit-related expenses decreased \$134 million to \$127 million in 1999 from \$261 million in 1998. The provision for losses fell \$70 million primarily due to an increase in recoveries on charged-off loans. Foreclosed property expenses dropped \$64 million with a decline in the number of foreclosed property acquisitions. The decrease in credit-related expenses resulted from strength in the economy and housing markets, a significant degree of risk sharing on higher risk loans, and continued loss mitigation efforts.

Administrative expenses grew \$92 million in 1999, or 13 percent, to \$800 million from \$708 million in 1998. The increase in administrative expenses resulted primarily from increased investment in technology and resources for the Portfolio Investment and Credit Guaranty business infrastructures

and in housing and community development initiatives. Compensation expense was \$496 million in 1999, compared with \$453 million in 1998.

The provision for federal income taxes, net of the tax benefit from extraordinary losses, was \$1.514 billion in 1999, compared with \$1.187 billion in 1998. The effective federal income tax rate was 28 percent in 1999 versus 26 percent in 1998. The effective federal income tax rate in 1998 reflected the implementation of improved systems and information that accelerated the timing of the recognition of the tax benefits associated with investments qualifying for low-income housing tax credits.

During 1999, the amount of long-term debt called or repurchased and the notional principal of related interest rate swaps called was \$42 billion, with a weighted-average cost of 6.80 percent. The comparable amount in 1998 was \$77 billion, with a weighted-average cost of 6.71 percent. As a result of repurchase and call activity, Fannie Mae recognized net extraordinary losses of \$14 million (\$9 million after tax) in 1999, compared with net extraordinary losses of \$40 million (\$26 million after tax) in 1998. The repurchase or call of high-coupon debt favorably affects Fannie Mae's future cost of funds.

FANNIE MAE

INDEX TO FINANCIAL STATEMENTS

	<u>Page</u>
Independent Auditors' Report	50
Statements of Income	51
Balance Sheets	52
Statements of Changes in Stockholders' Equity	53
Statements of Cash Flows	54
Notes to Financial Statements	55
Quarterly Results of Operations (Unaudited)	81
Net Interest Income and Average Balances (Unaudited)	83
Rate/Volume Analysis (Unaudited)	84

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of Fannie Mae:

We have audited the accompanying balance sheets of Fannie Mae as of December 31, 2000 and 1999, and the related statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2000. These financial statements are the responsibility of Fannie Mae's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Fannie Mae as of December 31, 2000 and 1999, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America.

We also have audited in accordance with auditing standards generally accepted in the United States of America the supplemental fair value balance sheets of Fannie Mae as of December 31, 2000 and 1999, included in Note 15 to the financial statements. As described in Note 15, the supplemental fair value balance sheets have been prepared by management to present relevant financial information that is not provided by the financial statements and is not intended to be a presentation in conformity with accounting principles generally accepted in the United States of America. In addition, the supplemental fair value balance sheets do not purport to present the net realizable, liquidation, or market value of Fannie Mae as a whole. Furthermore, amounts ultimately realized by Fannie Mae from the disposal of assets may vary significantly from the fair values presented. In our opinion, the supplemental fair value balance sheets included in Note 15 present fairly, in all material respects, the information set forth therein.

KPMG LLP

Washington, DC
January 11, 2001

FANNIE MAE
FINANCIAL STATEMENTS AND REPORTS
STATEMENTS OF INCOME

	<u>Year Ended December 31,</u>		
	<u>2000</u>	<u>1999</u>	<u>1998</u>
	(Dollars and shares in millions, except per common share amounts)		
Interest income:			
Mortgage portfolio	\$39,403	\$32,672	\$25,676
Investments and cash equivalents	<u>3,378</u>	<u>2,823</u>	<u>4,319</u>
Total interest income	<u>42,781</u>	<u>35,495</u>	<u>29,995</u>
Interest expense:			
Short-term debt	4,204	3,952	4,809
Long-term debt	<u>32,903</u>	<u>26,649</u>	<u>21,076</u>
Total interest expense	<u>37,107</u>	<u>30,601</u>	<u>25,885</u>
Net interest income	<u>5,674</u>	<u>4,894</u>	<u>4,110</u>
Other income:			
Guaranty fees	1,351	1,282	1,229
Fee and other income (expense)	<u>(44)</u>	<u>191</u>	<u>275</u>
Total other income	<u>1,307</u>	<u>1,473</u>	<u>1,504</u>
Other expenses:			
Provision for losses	(120)	(120)	(50)
Foreclosed property	214	247	311
Administrative	<u>905</u>	<u>800</u>	<u>708</u>
Total other expenses	<u>999</u>	<u>927</u>	<u>969</u>
Income before federal income taxes and extraordinary item	5,982	5,440	4,645
Provision for federal income taxes	<u>1,566</u>	<u>1,519</u>	<u>1,201</u>
Income before extraordinary item	4,416	3,921	3,444
Extraordinary item—gain (loss) on early extinguishment of debt (net of tax expense of \$17 million in 2000 and tax benefits of \$5 million in 1999 and \$14 million in 1998)	<u>32</u>	<u>(9)</u>	<u>(26)</u>
Net income	<u>\$ 4,448</u>	<u>\$ 3,912</u>	<u>\$ 3,418</u>
Preferred stock dividends	<u>121</u>	<u>78</u>	<u>66</u>
Net income available to common stockholders	<u>\$ 4,327</u>	<u>\$ 3,834</u>	<u>\$ 3,352</u>
Basic earnings per common share:			
Earnings before extraordinary item	\$ 4.28	\$ 3.75	\$ 3.28
Extraordinary gain (loss)	<u>.03</u>	<u>—</u>	<u>(.02)</u>
Net earnings	<u>\$ 4.31</u>	<u>\$ 3.75</u>	<u>\$ 3.26</u>
Diluted earnings per common share:			
Earnings before extraordinary item	\$ 4.26	\$ 3.73	\$ 3.26
Extraordinary gain (loss)	<u>.03</u>	<u>(.01)</u>	<u>(.03)</u>
Net earnings	<u>\$ 4.29</u>	<u>\$ 3.72</u>	<u>\$ 3.23</u>
Cash dividends per common share	\$ 1.12	\$ 1.08	\$.96
Weighted-average common shares outstanding:			
Basic	1,003	1,024	1,029
Diluted	1,009	1,031	1,037

See Notes to Financial Statements.

FANNIE MAE
BALANCE SHEETS

	December 31,	
	2000	1999
	(Dollars in millions, except share stated values)	
Assets		
Mortgage portfolio, net	\$607,399	\$522,780
Investments:		
Held-to-maturity	33,832	21,660
Available-for-sale	21,136	18,091
Cash and cash equivalents	617	2,099
Accrued interest receivable	4,529	3,530
Acquired property and foreclosure claims, net	636	708
Other	6,923	6,299
Total assets	\$675,072	\$575,167
Liabilities and Stockholders' Equity		
Liabilities:		
Debentures, notes and bonds, net:		
Due within one year	\$280,322	\$226,582
Due after one year	362,360	321,037
Total	642,682	547,619
Accrued interest payable	8,236	6,784
Other	3,316	3,135
Total liabilities	654,234	557,538
Stockholders' Equity:		
Preferred stock, \$50 stated value, 100 million shares authorized— 46 million shares outstanding in 2000 and 26 million shares outstanding in 1999.	2,278	1,300
Common stock, \$.525 stated value, no maximum authorization— 1,129 million shares outstanding	593	593
Additional paid-in capital	1,588	1,585
Retained earnings	21,619	18,417
Accumulated other comprehensive income	10	(246)
	26,088	21,649
Less: Treasury stock, at cost, 130 million shares in 2000 and 110 million shares in 1999.	5,250	4,020
Total stockholders' equity	20,838	17,629
Total liabilities and stockholders' equity	\$675,072	\$575,167

See Notes to Financial Statements.

FANNIE MAE

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Common Shares Outstanding	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
	(Dollars and shares in millions)							
Balance, January 1, 1998	1,037	\$1,000	\$593	\$1,495	\$13,326	\$ (1)	\$(2,620)	\$13,793
Comprehensive income:								
Net income	—	—	—	—	3,418	—	—	3,418
Other comprehensive income:								
Unrealized losses on available- for-sale securities, net of tax effect	—	—	—	—	—	(12)	—	(12)
Total comprehensive income								3,406
Dividends	—	—	—	—	(1,055)	—	—	(1,055)
Shares repurchased	(17)	—	—	—	—	—	(1,051)	(1,051)
Preferred stock issued	—	150	—	—	—	—	—	150
Treasury stock issued for stock options and benefit plans	5	—	—	38	—	—	172	210
Balance, December 31, 1998	1,025	1,150	593	1,533	15,689	(13)	(3,499)	15,453
Comprehensive income:								
Net income	—	—	—	—	3,912	—	—	3,912
Other comprehensive income:								
Unrealized losses on available- for-sale securities, net of tax effect	—	—	—	—	—	(233)	—	(233)
Total comprehensive income								3,679
Dividends	—	—	—	—	(1,184)	—	—	(1,184)
Shares repurchased	(10)	—	—	—	—	—	(653)	(653)
Preferred stock issued	—	150	—	(2)	—	—	—	148
Treasury stock issued for stock options and benefit plans	4	—	—	54	—	—	132	186
Balance, December 31, 1999	1,019	1,300	593	1,585	18,417	(246)	(4,020)	17,629
Comprehensive income:								
Net income	—	—	—	—	4,448	—	—	4,448
Other comprehensive income:								
Unrealized gains on available- for-sale securities, net of tax effect	—	—	—	—	—	256	—	256
Total comprehensive income								4,704
Dividends	—	—	—	—	(1,246)	—	—	(1,246)
Shares repurchased	(25)	—	—	—	—	—	(1,406)	(1,406)
Preferred stock issued	—	978	—	(10)	—	—	—	968
Treasury stock issued for stock options and benefit plans	5	—	—	13	—	—	176	189
Balance, December 31, 2000	<u>999</u>	<u>\$2,278</u>	<u>\$593</u>	<u>\$1,588</u>	<u>\$21,619</u>	<u>\$ 10</u>	<u>\$(5,250)</u>	<u>\$20,838</u>

See Notes to Financial Statements.

FANNIE MAE

STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2000	1999	1998
	(Dollars in millions)		
Cash flows from operating activities:			
Net income	\$ 4,448	\$ 3,912	\$ 3,418
Adjustments to reconcile net income to net cash provided by operating activities:			
Discount amortization on short-term debt	9,368	6,929	5,828
Negative provision for losses	(120)	(120)	(50)
(Gain) loss on early extinguishment of debt	(49)	14	40
Other (decreases) increases, net	(1,138)	1,120	(1,540)
Net cash provided by operating activities	12,509	11,855	7,696
Cash flows from investing activities:			
Purchases of mortgages	(152,075)	(193,434)	(189,721)
Proceeds from sales of mortgages	10,599	5,950	1,824
Mortgage principal repayments	56,193	77,789	86,918
Net proceeds from disposition of foreclosed properties ..	2,019	2,462	2,890
Net (increase) decrease in held-to-maturity investments ..	(12,172)	20,639	16,391
Net increase in available-for-sale investments	(3,045)	(1,875)	(10,310)
Net cash used in investing activities	(98,481)	(88,469)	(92,008)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt	110,298	138,491	149,034
Payments to redeem long-term debt	(50,320)	(62,464)	(95,920)
Proceeds from issuance of short-term debt	1,130,698	1,129,246	682,524
Payments to redeem short-term debt	(1,104,694)	(1,125,754)	(650,961)
Net payments from stock activities	(1,492)	(1,549)	(1,827)
Net cash provided by financing activities	84,490	77,970	82,850
Net (decrease) increase in cash and cash equivalents	(1,482)	1,356	(1,462)
Cash and cash equivalents at beginning of year	2,099	743	2,205
Cash and cash equivalents at end of year	\$ 617	\$ 2,099	\$ 743
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	\$ 34,863	\$ 28,447	\$ 24,415
Income taxes	1,595	1,276	555

See Notes to Financial Statements.

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Fannie Mae is a federally chartered and stockholder-owned corporation operating in the residential mortgage finance industry.

The accounting and reporting policies of Fannie Mae conform with accounting principles generally accepted in the United States of America. Certain amounts in prior years' financial statements have been reclassified to conform to the current presentation.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Mortgage Portfolio

Mortgages and mortgage-backed securities that Fannie Mae has the ability and positive intent to hold to maturity are classified as "held-to-maturity" and are carried at their unpaid principal balance (UPB) adjusted for unamortized purchase discount or premium and other deferred price adjustments. Mortgage loans held for sale are carried at the lower of cost or fair value, with any unrealized losses included in current period earnings. Mortgage-backed securities that Fannie Mae intends to hold for an undetermined period, but not necessarily to maturity, are classified as "available-for-sale" and are carried at fair value, with any valuation adjustments reported as a component of other comprehensive income, net of deferred taxes, in stockholders' equity.

Fannie Mae uses actual principal prepayment experience and estimates of future principal prepayments in calculating the constant effective yield necessary to apply the interest method in the amortization of purchase discount or premium and other deferred price adjustments. In evaluating prepayments, loans are aggregated by similar characteristics (e.g., loan type, acquisition date, and maturity). Factors used in determining estimates of future prepayments include historical prepayment data and expected prepayment performance under varying interest rate scenarios.

Interest income is not accrued on nonperforming loans. Conventional single-family and multifamily loans are classified as nonperforming and previously accrued interest is reversed against current period income when payment on the loan is 90 days or more delinquent. Once loans become performing, they are placed on accrual status and all reversed income is recognized in the period the loans become performing.

Investments

Investments consist of Fannie Mae's Liquid Investment Portfolio and other investments. Investments are classified as either held-to-maturity or available-for-sale. Investments classified as held-to-maturity are carried at historical cost, adjusted for unamortized discount or premium. Investments classified as available-for-sale are carried at fair value as of the balance sheet date, with any valuation adjustments reported as a component of other comprehensive income, net of deferred taxes, in stockholders' equity. Interest income is recognized on an accrual basis unless the collection of interest income is considered doubtful, in which case interest income is recognized on a cash basis.

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

Guaranteed Mortgage-Backed Securities

Fannie Mae guarantees the timely payment of principal and interest on most Fannie Mae Mortgage-Backed Securities (MBS). These securities represent beneficial interests in pools of mortgages or other MBS held in trust by Fannie Mae. The pools of mortgages or MBS are not assets of Fannie Mae, except when acquired for investment purposes, nor are the related outstanding securities liabilities; accordingly, neither are reflected on the accompanying balance sheets. Fannie Mae receives monthly guaranty fees for each MBS mortgage pool based on a percentage of the pool's outstanding balance. Adjustments to the guaranty fee rate effected through an upfront payment at securitization are deferred and amortized into guaranty fee income over the estimated life of the underlying loans using the interest method. For MBS pools held in Fannie Mae's portfolio, the guaranty fee is reflected as interest income.

Allowance for Losses

The allowance for losses is based on an analysis of portfolio loans and MBS outstanding and provides for known probable losses and losses inherent in the mortgage portfolio and MBS. Management's analysis considers current delinquency levels, historical loss experience, current economic conditions, payment performance in areas of geographic concentration, and mortgage characteristics. The allowance for losses is established by recording an expense for the provision for losses and may be reduced by recording a negative provision if management believes the allowance amount exceeds expected losses. The allowance for losses is subsequently reduced through charge-offs on foreclosed properties and is increased through recoveries on foreclosed properties. In management's judgment, the allowance for losses is adequate to provide for expected losses. The primary components of the allowance for losses are an allowance for losses on loans in the retained mortgage portfolio, which is included in the balance sheet under "Mortgage portfolio, net," and an allowance for losses on loans underlying guaranteed MBS, which is included in the balance sheet under "Other liabilities."

Acquired Property

Foreclosed assets are carried at the lower of cost or fair value less estimated costs to sell. Cost is determined based on the fair value of the collateral at the date of the foreclosure and represents the amount that a willing seller could reasonably expect from a willing buyer in an arm's-length transaction. The difference between the estimated fair value of the collateral at foreclosure and the principal owed on the underlying loan is recorded as either a charge-off or recovery against the allowance for losses at foreclosure. Foreclosure, holding, and disposition costs are charged directly to earnings.

Hedging Instruments

Fannie Mae uses certain derivative instruments, such as interest rate swaps, swaptions, derivative instruments that simulate the short sale of U.S. Treasury securities, interest rate caps, deferred rate-setting agreements, and foreign currency swaps, to achieve a specific financing or investment objective at a desired cost or yield. Fannie Mae does not engage in trading or other speculative use of these derivative instruments. Specific criteria must be met for a derivative instrument to qualify as a hedge on either an accrual or a deferred basis. Derivative instruments not qualifying as hedges are marked to market through earnings. Derivative instruments used as hedges must maintain a high correlation between the hedging instrument and the item being hedged, both at inception and throughout the hedge period.

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

Interest rate swaps are contractual agreements between two parties for the exchange of periodic payments, generally based on a notional principal amount and agreed-upon fixed and variable rates. Fannie Mae has long-term interest rate swap agreements with various parties to extend the effective maturity of certain short-term debt obligations and to adjust the effective maturity of certain long-term debt obligations. Fannie Mae also has interest rate swap agreements that are linked to specific debt issues (debt swaps) or specific investments (asset swaps). These swaps achieve a specific financing or investment objective at a desired cost or yield. The costs and terms of the specific debt issues and yields of these specific investments, as presented in the financial statements, include the effects of these swaps. Interest rate swaps are accounted for on an accrual basis with the net payable or receivable recognized as an adjustment to interest income or expense on the hedged assets or liabilities. Gains or losses on terminated interest rate swaps are deferred and amortized over the shorter of the remaining life of the hedged items or the term of the original swap. The fair value of the interest rate swap agreements and changes in these fair values are not recognized in the financial statements.

Swaptions are derivative instruments that provide Fannie Mae with the option to enter into an interest rate swap at a future date, thereby mirroring the economic effect of callable debt. Swaptions are used to hedge planned debt issuances or existing debt instruments. The fair value of the swaptions and changes in these fair values are not recognized in the financial statements. The premium paid for a swaption is amortized over the estimated life of the swaption.

Derivative instruments that simulate short sales of U.S. Treasury and agency securities and interest rate swaps are used to hedge interest rate risk on planned debt issuances. Gains and losses that result from the hedge positions are deferred and recognized as adjustments to debt costs over the life of the hedged debt issuances.

Interest rate caps are agreements with a counterparty to effectively cap Fannie Mae's exposure on a variable-rate debt instrument in a rising interest rate environment. In exchange for a premium paid to a counterparty for the cap, the counterparty agrees to pay Fannie Mae an amount equal to any interest on the notional amount in excess of the agreed-upon rate. Interest rate caps are used for upward rate protection on variable-rate debt. The fair value of the interest rate caps and changes in these fair values are not recognized in the financial statements. The premium paid for a cap is amortized over the life of the cap.

Fannie Mae enters into deferred rate-setting agreements when fixed-rate debt is issued prior to the commitment for mortgages that the debt will fund. Under these agreements, Fannie Mae is able to set the effective interest rate on the debt based on prevailing market conditions at one or more future dates. At settlement of all or a portion of a deferred rate-setting agreement, Fannie Mae pays or receives cash in an amount representing the present value of the interest rate differential between the fixed-rate debt and the prevailing rate. Gains and losses that result from the hedge position are deferred and recognized as adjustments to debt cost over the life of the debt issuance.

Fannie Mae issues debt securities in which principal, interest, or both are payable in a foreign currency or are determined by reference to an index that includes one or more foreign currencies. Concurrently, Fannie Mae enters into currency swaps that convert the proceeds of certain borrowings into dollars or provide for scheduled exchanges of the currencies to insulate Fannie Mae against foreign currency exchange risk. Foreign currency swaps are accounted for on an accrual basis with the net differential received or paid under such swaps recognized as an adjustment to interest income or expense on the related asset or liability. Foreign currency borrowings and the related net receivables and payables from currency swaps are translated at the market rates of exchange as of the balance sheet date.

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

Cash and Cash Equivalents

Fannie Mae considers highly liquid investment instruments, generally with an original maturity of three months or less, to be cash equivalents. Cash equivalents are carried at cost, which approximates fair value.

Income Taxes

Deferred federal income tax assets and liabilities are established for temporary differences between financial and taxable income and are measured using the current marginal statutory tax rate. Investment and other tax credits are generally recognized when recorded on the tax return.

Comprehensive Income

Comprehensive income is defined as the change in equity of a business enterprise from transactions and other events and circumstances from nonowner sources during a period. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners.

New Accounting Standards

In June 1998, the Financial Accounting Standards Board issued Financial Accounting Standard No. 133 (FAS 133), *Accounting for Derivative Instruments and Hedging Activities*, as amended by FAS 138. FAS 133 requires that all derivatives be recognized as either assets or liabilities on the balance sheet at fair value. Subject to certain qualifying conditions, a derivative may be designated as either a hedge of the fair value of a fixed-rate instrument (fair value hedge) or a hedge of the cash flows of a variable-rate instrument or anticipated transaction (cash flow hedge). For a derivative qualifying as a fair value hedge, fair value gains or losses on the derivative are reported in earnings along with offsetting fair value gains or losses on the hedge item attributable to the risk being hedged. For a derivative qualifying as a cash flow hedge, fair value gains or losses associated with the risk being hedged would be reported in a separate component of stockholders' equity (other comprehensive income) and then amortized into earnings in the period(s) in which the hedged item affects income. For a derivative not qualifying as a hedge, or components of a derivative that are excluded from any hedge effectiveness assessment, fair value gains and losses are reported in earnings. This statement was effective for Fannie Mae beginning January 1, 2001. The cumulative after-tax effect on January 1, 2001 of the adoption of FAS 133 was \$168 million of income and a \$3.9 billion loss in the other comprehensive income component of stockholders' equity.

In September 2000, the Financial Accounting Standards Board issued Financial Accounting Standard No. 140 (FAS 140), a replacement of FAS 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*. The collateral and disclosure provisions of FAS 140 were effective for Fannie Mae for the fiscal year ending December 31, 2000. The provisions governing transfers and servicing of financial assets and extinguishment of liabilities become effective April 1, 2001. In management's opinion, these provisions of FAS 140 will not have a material impact on Fannie Mae.

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

2. Mortgage Portfolio, Net

The mortgage portfolio consisted of the following at December 31, 2000 and 1999.

	<u>2000</u>	<u>1999</u>
	(Dollars in millions)	
Single-family mortgages:		
Government insured or guaranteed	\$ 44,166	\$ 41,029
Conventional:		
Long-term, fixed-rate	454,349	385,321
Intermediate-term, fixed-rate(1)	66,619	69,019
Adjustable-rate	27,135	14,107
Second	<u>480</u>	<u>176</u>
	<u>592,749</u>	<u>509,652</u>
Multifamily mortgages:		
Government insured	7,184	4,345
Conventional	<u>10,189</u>	<u>9,944</u>
	<u>17,373</u>	<u>14,289</u>
Total unpaid principal balance	610,122	523,941
Less:		
Unamortized discount and deferred price adjustments, net	2,520	964
Allowance for losses	<u>203</u>	<u>197</u>
Mortgage portfolio, net	<u>\$607,399</u>	<u>\$522,780</u>

(1) Intermediate-term consists of portfolio loans with contractual maturities at purchase equal to or less than 20 years and MBS held in portfolio with maturities of 15 years or less at issue date.

Included in the mortgage portfolio are \$455 billion and \$374 billion of MBS and other mortgage-related securities at December 31, 2000 and 1999, respectively, with fair values of \$459 billion and \$362 billion, respectively. MBS held in portfolio at December 31, 2000 and 1999 included \$114 billion and \$100 billion, respectively, of Real Estate Mortgage Investment Conduits (REMICs) and Stripped MBS (SMBS). REMICs and SMBS backed by MBS do not subject Fannie Mae to added credit risk but generally have different interest rate risks than MBS. At December 31, 2000, these securities had aggregate gross unrealized losses of \$716 million and gross unrealized gains of \$1.8 billion. At December 31, 1999, the aggregate gross unrealized losses and gains on these securities were \$3.8 billion and \$743 million, respectively.

Mortgage securities and loans held for sale were \$11 billion with unrealized losses of \$3 million at December 31, 2000 and \$9 billion with unrealized losses of \$377 million at December 31, 1999.

The UPB of impaired loans at December 31, 2000 was \$186 million, of which \$67 million had a specific loss allowance. At December 31, 1999, the UPB of impaired loans was \$225 million, of which \$64 million had a specific loss allowance. The average balance of impaired loans during 2000 and 1999 was \$210 million and \$232 million, respectively. A loan is impaired when, based on current information and events, it is probable that all of the contractual principal and interest payments will

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

not be collected as scheduled in the loan agreement. All of Fannie Mae's impaired loans are multifamily loans.

Nonperforming loans outstanding totaled \$1.9 billion at the end of 2000, compared with \$2.6 billion at the end of 1999. If nonperforming loans had been fully performing at year end, they would have contributed an additional \$43 million to net interest income in 2000 and \$108 million in 1999.

3. Allowance for Losses

Changes in the allowance for the years 1998 through 2000 are summarized below.

	<u>Total</u> (Dollars in millions)
Balance, January 1, 1998.....	\$ 803
Provision	(50)
Net recoveries	<u>49</u>
Balance, December 31, 1998.....	802
Provision	(120)
Net recoveries	<u>122</u>
Balance, December 31, 1999.....	804
Provision	(120)
Net recoveries	<u>125</u>
Balance, December 31, 2000.....	<u>\$ 809</u>

At December 31, 2000, \$203 million of the allowance for losses was included in the balance sheet under "Mortgage portfolio, net," which represents the allocation for portfolio loan losses; \$603 million was included in liabilities under "Other" for estimated losses on MBS; and the remainder, or \$3 million, which relates to unrecoverable losses on Federal Housing Administration loans, was included in "Acquired property and foreclosure claims, net." The corresponding amounts at December 31, 1999 were \$197 million, \$604 million, and \$3 million, respectively. The allowance for losses at December 31, 2000 included \$2 million of specific allowances for impaired loans with a UPB of \$67 million, compared with \$3 million of specific allowances for impaired loans with a UPB of \$64 million at December 31, 1999. During 2000, Fannie Mae established \$11 million of specific allowances for impaired loans, compared with \$4 million in 1999.

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

4. Investments

Presented below are the amortized cost and fair value of the Liquid Investment Portfolio and other investments classified as held-to-maturity at December 31, 2000 and 1999.

	2000				1999			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in millions)							
Held-to-maturity investments:								
Asset-backed securities	\$ 9,043	\$23	\$—	\$ 9,066	\$ 8,974	\$—	\$19	\$ 8,955
Commercial paper....	8,893	2	—	8,895	1,723	2	—	1,725
Eurodollar time deposits	4,046	—	—	4,046	350	—	—	350
Federal funds	3,493	—	—	3,493	4,487	—	—	4,487
Repurchase agreements	2,722	—	—	2,722	2,574	—	—	2,574
Auction rate preferred stock	1,812	—	—	1,812	1,042	—	—	1,042
Other	<u>3,823</u>	<u>29</u>	<u>—</u>	<u>3,852</u>	<u>2,510</u>	<u>—</u>	<u>20</u>	<u>2,490</u>
Total	<u>\$33,832</u>	<u>\$54</u>	<u>\$—</u>	<u>\$33,886</u>	<u>\$21,660</u>	<u>\$ 2</u>	<u>\$39</u>	<u>\$21,623</u>

Presented below are the amortized cost and fair value of the Liquid Investment Portfolio and other investments classified as available-for-sale at December 31, 2000 and 1999.

	2000				1999			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in millions)							
Available-for-sale investments:								
Asset-backed securities	\$ 8,469	\$—	\$—	\$ 8,469	\$10,240	\$—	\$ 7	\$10,233
Other	<u>12,680</u>	<u>—</u>	<u>13</u>	<u>12,667</u>	<u>7,852</u>	<u>6</u>	<u>—</u>	<u>7,858</u>
Total	<u>\$21,149</u>	<u>\$—</u>	<u>\$13</u>	<u>\$21,136</u>	<u>\$18,092</u>	<u>\$ 6</u>	<u>\$ 7</u>	<u>\$18,091</u>

The following table shows the amortized cost, fair value, and yield of the Liquid Investment Portfolio and other investments by remaining maturity at December 31, 2000 and 1999.

	2000			1999		
	Amortized Cost	Fair Value	Yield	Amortized Cost	Fair Value	Yield
	(Dollars in millions)					
Due within one year	\$27,026	\$27,010	6.85%	\$12,660	\$12,659	6.19%
Due after one year through five years.....	<u>10,443</u>	<u>10,477</u>	<u>7.12</u>	<u>8,033</u>	<u>8,022</u>	<u>6.37</u>
	37,469	37,487	6.93	20,693	20,681	6.26
Asset-backed securities(1)	<u>17,512</u>	<u>17,535</u>	<u>6.84</u>	<u>19,059</u>	<u>19,033</u>	<u>6.30</u>
Total.....	<u>\$54,981</u>	<u>\$55,022</u>	<u>6.90%</u>	<u>\$39,752</u>	<u>\$39,714</u>	<u>6.28%</u>

(1) Contractual maturity of asset-backed securities is not a reliable indicator of their expected life because borrowers generally have the right to repay their obligations at any time.

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

5. Debentures, Notes, and Bonds, Net

Borrowings Due Within One Year

Borrowings due within one year at December 31, 2000 and 1999 are summarized below. Amounts are net of unamortized discount and premium.

	2000					1999				
	Outstanding at December 31		Average Outstanding During Year		Maximum Outstanding at any Month-end	Outstanding at December 31		Average Outstanding During Year		Maximum Outstanding at any Month-end
	Amount	Cost (1)	Amount	Cost (1)		Amount	Cost (1)	Amount	Cost (1)	
(Dollars in millions)										
Short-term notes	\$178,292	6.50%	\$150,242	6.33%	\$178,292	\$147,598	5.68%	\$135,919	5.18%	\$148,593
Other short-term debt	42,157	6.58	37,880	6.36	42,157	37,455	6.01	33,798	5.19	37,455
Current portion of borrowings due after one year(2):										
Universal Standard debt	51,185	6.02				40,869	6.04			
Universal Benchmark debt	6,984	5.71				—	—			
Universal Retail debt	785	6.62				127	6.06			
Other	<u>919</u>	<u>6.57</u>				<u>533</u>	<u>6.03</u>			
Total due within one year	<u>\$280,322</u>	<u>6.38%</u>				<u>\$226,582</u>	<u>5.80%</u>			

- (1) Represents weighted-average cost, which includes the amortization of discounts, premiums, issuance costs, hedging results, and the effects of currency and debt swaps.
- (2) Information on average amount and cost of debt outstanding during the year and maximum amount outstanding at any month-end is not meaningful. See “Borrowings Due After One Year” for additional information.

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

Borrowings Due After One Year

Borrowings due after one year at December 31, 2000 and 1999 consisted of the following:

	Maturity Date	2000		1999	
		Amount Outstanding	Average Cost (1)	Amount Outstanding	Average Cost (1)
(Dollars in millions)					
Universal Benchmark debt, net of \$1,106 of discount for 2000 (\$1,057 for 1999)	2001-2030	\$185,771	6.42%	\$113,405	6.02%
Universal Standard debt, net of \$404 of discount for 2000 (\$683 for 1999)	2001-2038	165,680	6.42	197,963	6.29
Universal Retail debt, net of \$52 of discount for 2000 (\$37 for 1999) ..	2001-2016	7,083	6.82	5,524	6.52
Long-term other, net of \$14,749 of discount for 2000 (\$15,280 for 1999)	2001-2021	<u>4,788</u>	<u>8.58</u>	<u>4,561</u>	<u>8.16</u>
		363,322	6.46%	321,453	6.22%
Adjustment for foreign currency translation		<u>(962)</u>		<u>(416)</u>	
Total due after one year		<u>\$362,360</u>		<u>\$321,037</u>	

(1) Represents weighted-average cost, which includes the amortization of discounts, premiums, issuance costs, hedging results, and the effects of currency and debt swaps.

Universal debt represents a consolidation of Fannie Mae's outstanding debt agreements for its various funding programs into one comprehensive offering document, the Universal Debt Facility, which supersedes and replaces the Global Debt Facility, Medium-Term Notes, Short-Term Notes and Debenture Programs and applies to debt settling after January 3, 2000.

Debentures, notes, and bonds at December 31, 2000 included \$173 billion of callable debt, which generally is redeemable, in whole or in part, at the option of Fannie Mae any time on or after a specified date. At December 31, 2000, debentures, notes, and bonds did not include any debt instruments that are subject to mandatory redemptions tied to certain indices or rates after an initial nonredemption period.

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

The following table summarizes the amounts and call periods of callable debt, the notional amount of callable swaps, other redeemable debt and swaps, and other option-embedded financial instruments, excluding \$11 billion of callable debt that was swapped to variable-rate debt. Universal debt that is redeemable at Fannie Mae's option is also included in the table.

<u>Call Date</u>	<u>Year of Maturity</u>	<u>Amount Outstanding</u>	<u>Average Cost</u>
	(Dollars in millions)		
Callable debt and callable swaps:			
Currently callable	2001-2025	\$ 90,528	6.04%
2001	2001-2026	60,355	6.53
2002	2003-2027	34,525	6.79
2003	2005-2028	17,594	6.54
2004	2007-2014	21,480	6.75
2005	2010-2030	5,675	7.20
2006 and later	2012-2029	<u>3,045</u>	<u>7.36</u>
		233,202	6.42%
Other option-embedded financial instruments		<u>47,213</u>	
Total option-embedded financial instruments		<u>\$280,415</u>	

Principal amounts at December 31, 2000 of total debt payable in the years 2002-2006, assuming callable debt is paid at maturity and assuming callable debt is redeemed at the initial call date, were as follows:

	<u>Total Debt by Year of Maturity (1)</u>	<u>Assuming Callable Debt Redeemed at Initial Call Date (1)</u>
	(Dollars in millions)	
2002	\$55,769	\$57,026
2003	53,924	27,723
2004	56,501	36,476
2005	41,767	27,467
2006	8,792	2,812

(1) Excludes \$11 billion of callable debt that was swapped to variable-rate debt.

Fannie Mae repurchased or called \$18 billion of debt and swaps with an average cost of 7.10 percent in 2000 and \$42 billion of debt and swaps with an average cost of 6.80 percent in 1999. Fannie Mae recorded extraordinary gains of \$49 million (\$32 million after tax) in 2000 and extraordinary losses of \$14 million (\$9 million after tax) in 1999 on the early extinguishment of debt.

Pursuant to Fannie Mae's Charter Act, approval of the Secretary of the Treasury is required for Fannie Mae's issuance of its debt obligations.

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

6. Income Taxes

Components of the provision for federal income taxes for the years ended December 31, 2000, 1999, and 1998 were as follows:

	2000	1999	1998
	(Dollars in millions)		
Current	\$1,412	\$1,289	\$ 692
Deferred	154	230	509
	1,566	1,519	1,201
Tax expense (benefit) of extraordinary gain (loss) ...	17	(5)	(14)
Net federal income tax provision	\$1,583	\$1,514	\$1,187

The tax effects of temporary differences that gave rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2000 and 1999 consisted of the following:

	2000	1999
	(Dollars in millions)	
Deferred tax assets:		
MBS guaranty and REMIC fees	\$ 633	\$ 592
Provision for losses	317	335
Unrealized (gains) losses on available-for-sale securities	(6)	132
Other items, net	124	114
Deferred tax assets	1,068	1,173
Deferred tax liabilities:		
Debt-related expenses	576	588
Purchase discount and deferred fees	490	351
Benefits from tax-advantaged investments	108	115
Other items, net	43	44
Deferred tax liabilities	1,217	1,098
Net deferred tax (liability) asset	\$ (149)	\$ 75

Management anticipates it is more likely than not that the results of future operations will generate sufficient taxable income to realize the entire balance of deferred tax assets.

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

Fannie Mae's effective tax rates differed from statutory federal rates for the years ended December 31, 2000, 1999, and 1998 as follows:

	2000	1999	1998
Statutory corporate rate	35%	35%	35%
Tax-exempt interest and dividends received deductions	(5)	(4)	(4)
Equity investments in affordable housing projects	(4)	(3)	(5)
Effective rate	<u>26%</u>	<u>28%</u>	<u>26%</u>

Fannie Mae is exempt from state and local taxes, except for real estate taxes.

7. Earnings per Common Share

The following table sets forth the computation of basic and diluted earnings per common share.

	Year Ended December 31,					
	2000		1999		1998	
	Basic	Diluted	Basic	Diluted	Basic	Diluted
(Dollars and shares in millions, except per share amounts)						
Net income before extraordinary item	\$ 4,416	\$ 4,416	\$ 3,921	\$ 3,921	\$ 3,444	\$ 3,444
Less: Extraordinary gain (loss)	32	32	(9)	(9)	(26)	(26)
Preferred stock dividend	(121)	(121)	(78)	(78)	(66)	(66)
Net income available to common stockholders	<u>\$ 4,327</u>	<u>\$ 4,327</u>	<u>\$ 3,834</u>	<u>\$ 3,834</u>	<u>\$ 3,352</u>	<u>\$ 3,352</u>
Weighted-average common shares	1,003	1,003	1,024	1,024	1,029	1,029
Dilutive potential common shares(1)	<u>—</u>	<u>6</u>	<u>—</u>	<u>7</u>	<u>—</u>	<u>8</u>
Average number of common shares outstanding used to calculate earnings per common share	<u>1,003</u>	<u>1,009</u>	<u>1,024</u>	<u>1,031</u>	<u>1,029</u>	<u>1,037</u>
Earnings per common share before extraordinary item	\$ 4.28	\$ 4.26	\$ 3.75	\$ 3.73	\$ 3.28	\$ 3.26
Net earnings per common share	<u>4.31</u>	<u>4.29</u>	<u>3.75</u>	<u>3.72</u>	<u>3.26</u>	<u>3.23</u>

(1) Dilutive potential common shares consist primarily of the dilutive effect from employee stock options and other stock compensation plans.

For additional disclosures regarding Fannie Mae's stock compensation plans and the outstanding preferred stock, refer to Notes 8 and 12, respectively.

8. Stock Compensation Plans

At December 31, 2000, Fannie Mae had five stock-based compensation plans, which are described below. Financial Accounting Standard No. 123 (FAS 123), *Accounting for Stock-Based Compensation*, gives companies the option of either recording an expense for all stock compensation awards based on the fair value at grant date or continuing to follow Accounting Principles Board Opinion No. 25 (APB Opinion 25) with the additional requirement that they disclose, in a footnote, pro forma

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

net income and earnings per share as if they had adopted the expense recognition provisions of FAS 123. Fannie Mae elected to apply APB Opinion 25 and related interpretations in accounting for its plans. Thus, no compensation expense has been recognized for the nonqualified stock options and Employee Stock Purchase Plan. If compensation expense had been recognized for benefits under all five plans, based on their fair value at grant date and consistent with FAS 123, Fannie Mae's net income and net earnings per common share would have been \$4.187 billion and \$4.15, \$3.840 billion and \$3.65, and \$3.312 billion and \$3.19 for the years ended December 31, 2000, 1999, and 1998, respectively.

Fannie Mae determined the fair value of benefits under its stock-based plans using a Black-Scholes pricing model. The following table summarizes the major assumptions used in the model.

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Risk-free rate(1)	4.97 - 6.81%	4.56 - 6.02%	4.04 - 5.79%
Volatility	29 - 34	27 - 29	25 - 30
Forfeiture	15	15	15
Dividend(2)	\$1.12	\$1.08	\$.96
Expiration.....	1 - 10 yrs.	1 - 10 yrs.	1 - 10 yrs.

(1) The closing yield on the comparable average life U.S. Treasury on the day prior to grant.

(2) Dividend rate on common stock at date of grant. Dividend rate assumed to remain constant over the option life.

Employee Stock Purchase Plan

Fannie Mae has an Employee Stock Purchase Plan that allows issuance of up to 41 million shares of common stock to qualified employees at a price equal to 85 percent of the fair market value on the grant date. In 2000, Fannie Mae granted each qualified employee, excluding certain officers and other highly compensated employees, the right to purchase up to 419 shares of common stock in January 2001. Under the 2000 offering, 1,522,869 shares were purchased at \$50.68 per share, compared with 9,566 common shares purchased at \$60.99 per share under the 1999 offering. The Board of Directors approved a 2001 offering under the plan, granting each qualified employee the right to purchase 321 common shares at \$66.00 per share in January 2002.

Employee Stock Ownership Plan

Fannie Mae has an Employee Stock Ownership Plan (ESOP) for qualified employees. Fannie Mae may contribute to the ESOP an amount based on defined earnings goals, not to exceed 4 percent of the aggregate base salary for all participants. The contribution is made in the subsequent year either in shares of Fannie Mae common stock or in cash that is used to purchase such stock.

Performance Shares

Fannie Mae's Stock Compensation Plans authorize eligible employees to receive performance awards, generally issued with an award period that can range from three to five years. The performance awards become actual awards only if Fannie Mae attains the goals set for the award period. At the end of such time, the awards generally are payable in common stock, in either two or three installments over a period not longer than three years. The outstanding contingent grants made

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

for the 2001-2003, 2000-2002, and 1999-2001 periods were 453,130 common shares, 408,645 common shares, and 331,254 common shares, respectively.

Nonqualified Stock Options

Stock options may be granted to eligible employees and nonmanagement members of the Board of Directors. The options generally do not become exercisable until at least one year after the grant date for employees and on the grant date for nonmanagement directors and generally expire ten years from the grant date. The exercise price of the common stock covered by each option is equal to the fair value of the stock on the date the option is granted.

Under the Nonqualified Stock Option plan, Fannie Mae's Board of Directors approved the EPS Challenge Option Grant in January 2000 for all regular full-time and part-time Fannie Mae employees. All employees, other than management group employees, received an option grant of 350 shares at a price of \$62.50 per share, the fair market value of the stock on the grant date. Management group employees received option grants equivalent to a percentage of their November 1999 stock grants. Vesting for options granted is tied to achievement of an earnings per share (EPS) goal, which is \$6.46 by the end of 2003. If Fannie Mae's EPS for 2003 is \$6.46 or greater, then 100 percent of the EPS Challenge options will vest in January 2004. If Fannie Mae does not reach an EPS of \$6.46 by the end of 2003, vesting is delayed one year and then begins at a rate of 25 percent per year. The Board of Directors may choose, at its discretion, to offset future option grants or other forms of compensation if the goal is not reached. Options expire January 18, 2010.

The following table summarizes stock option activity for the years 1998-2000.

	<u>2000</u>		<u>1999</u>		<u>1998</u>	
	<u>Options</u>	<u>Weighted-Average Exercise Price</u>	<u>Options</u>	<u>Weighted-Average Exercise Price</u>	<u>Options</u>	<u>Weighted-Average Exercise Price</u>
	(Options in thousands)					
Balance, January 1,	22,349	\$40.90	21,994	\$34.55	22,777	\$27.15
Granted	7,741	66.79	3,224	71.20	3,381	67.63
Exercised	(4,003)	23.88	(2,499)	22.52	(3,712)	19.15
Forfeited	(777)	61.98	(370)	51.85	(452)	35.60
Balance, December 31,	<u>25,310</u>	<u>\$50.86</u>	<u>22,349</u>	<u>\$40.90</u>	<u>21,994</u>	<u>\$34.55</u>
Options vested, December 31,	<u>13,551</u>	<u>\$36.83</u>	<u>14,727</u>	<u>\$29.26</u>	<u>13,729</u>	<u>\$23.89</u>

The following table summarizes information about stock options outstanding at December 31, 2000.

<u>Range of Exercise Prices</u>	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
	<u>Number of Options</u>	<u>Weighted-Average Remaining Contractual Life</u>	<u>Weighted-Average Exercise Price</u>	<u>Number of Options</u>	<u>Weighted-Average Exercise Price</u>
	(Options in thousands)				
\$13.00 - \$26.00	4,421	3.2 yrs.	\$18.45	4,421	\$18.45
26.01 - 48.00	5,138	5.4	33.09	5,049	32.95
48.01 - 65.00	7,537	8.3	58.13	2,112	53.63
65.01 - 85.00	<u>8,214</u>	<u>8.9</u>	<u>72.75</u>	<u>1,969</u>	<u>70.05</u>
Total	<u>25,310</u>	<u>7.0 yrs.</u>	<u>\$50.86</u>	<u>13,551</u>	<u>\$36.83</u>

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

Restricted Stock

In 2000, 192,301 shares of restricted stock were awarded, issued, and placed in escrow under the Stock Compensation Plans and the Restricted Stock Plan for Directors (140,460 shares in 1999); 92,141 shares were released as vesting of participants occurred (76,060 shares in 1999).

9. Employee Retirement Benefits

Retirement Savings Plan

All regular employees of Fannie Mae scheduled to work 1,000 hours or more in a calendar year are eligible to participate in the company's Retirement Savings Plan, which includes a 401(k) option. In 2000, employees could contribute up to the lesser of 15 percent of their base salary or the current annual dollar cap established and revised annually by the Internal Revenue Service. Fannie Mae matches employee contributions up to 3 percent of base salary.

Postretirement Benefit Plans

All regular employees of Fannie Mae scheduled to work 1,000 hours or more in a calendar year are covered by a noncontributory corporate retirement plan or by the contributory Civil Service Retirement Law. Benefits payable under the corporate plan are based on years of service and compensation using the average pay during the 36 consecutive highest-paid months of the last 120 months of employment. Fannie Mae's policy is to contribute an amount no less than the minimum required employer contribution under the Employee Retirement Income Security Act of 1974. Contributions to the corporate plan reflect benefits attributed to employees' service to date and compensation expected to be paid in the future. No contribution was made to the corporate plan in 2000. Corporate plan assets consist primarily of listed stocks, fixed-income securities, and other liquid assets.

At December 31, 2000 and 1999, the projected benefit obligations for services rendered were \$263 million and \$200 million, respectively, while the plan assets were \$261 million and \$277 million, respectively. The pension liability (included in liabilities under "Other") at December 31, 2000 and 1999 was \$51 million and \$46 million, respectively. Net periodic pension costs were \$5 million, \$8 million, and \$9 million for the years ended December 31, 2000, 1999, and 1998, respectively. Fannie Mae uses the straight-line method of amortization for prior service costs.

At December 31, 2000 and 1999, the weighted-average discount rates used in determining the actuarial present value of the projected benefit obligation were 7.75 percent and 8.00 percent, respectively. The assumptions used in determining the net periodic pension costs were as follows:

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Weighted-average discount rate	8.00%	7.13%	7.25%
Average rate of increase in future compensation levels	6.50	5.75	5.75
Expected long-term weighted-average rate of return on plan assets	9.00	9.25	9.25

Fannie Mae also has an Executive Pension Plan and a Supplemental Pension Plan, which supplement the benefits payable under the retirement plan for key senior officers. Accrued benefits under the Executive Pension Plan generally are funded through a Rabbi trust. Estimated benefits under the supplementary plans are accrued as an expense over the period of employment.

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

Fannie Mae sponsors a Postretirement Health Care Plan that covers substantially all full-time employees. The plan pays stated percentages of most necessary medical expenses incurred by retirees, after subtracting payments by Medicare or other providers and after a stated deductible has been met. Participants become eligible for the subsidized benefits as follows: (1) for employees hired prior to January 1, 1998, if they retire from Fannie Mae after reaching age 55 with five or more years of service; or (2) for employees hired January 1, 1998, or later, if they retire from Fannie Mae after reaching age 55 with ten or more years of service. Employees hired January 1, 1998 or later who retire with less than ten years of service may purchase coverage by paying the full premium. The plan is contributory, with retiree contributions adjusted annually. The expected cost of these postretirement benefits is charged to expense during the years that employees render service. Cost-sharing percentages are based on length of service with Fannie Mae, eligibility for and date of retirement, and a defined dollar benefit cap. Fannie Mae does not fund this plan.

Fannie Mae's accrued postretirement health care cost liability for the years ending December 31, 2000 and 1999 was \$46 million and \$40 million, respectively. The net postretirement health care costs were \$8 million, \$9 million, and \$8 million for the years ended December 31, 2000, 1999, and 1998, respectively. In determining the net postretirement health care cost for 2000, a 5.00 percent annual rate of increase in the per capita cost of covered health care claims was assumed with the rate decreasing gradually over the next two years to 4.50 percent and remaining at that level thereafter. In determining the net postretirement health care cost for 1999, a 5.25 percent annual rate of increase in the per capita cost of covered health care claims was assumed with the rate decreasing gradually over the next three years to 4.50 percent and remaining at that level thereafter. In determining the net postretirement health care cost for 1998, a 5.50 percent annual rate of increase in the per capita cost of covered health care claims was assumed with the rate decreasing gradually over the next four years to 4.50 percent and remaining at that level thereafter. The health care cost trend rate assumption has a significant effect on the amounts reported. To illustrate, increasing the assumed health care cost trend rates by one percentage point in each year would increase the accumulated postretirement benefit obligation as of December 31, 2000 by \$8 million and the aggregate of the service and interest cost components of net postretirement health care cost for the year by \$1 million.

The weighted-average discount rates used in determining the health care cost and the year-end accumulated postretirement benefit obligation were 7.75 percent at December 31, 2000, 8.00 percent at December 31, 1999, and 6.75 percent at December 31, 1998.

10. Line of Business Reporting

Management analyzes corporate performance on the basis of two lines of business: Portfolio Investment and Credit Guaranty.

The Portfolio Investment business includes the management of asset purchases and funding activities for Fannie Mae's mortgage portfolio and investment portfolio. Income is derived primarily from the difference, or spread, between the yield on mortgage loans and investments, and the borrowing costs related to those loans and investments.

The Credit Guaranty business involves guaranteeing the credit performance of both single-family and multifamily mortgage loans for a fee. Guaranty fees for MBS are based on a market rate of return for the credit risk assumed. For mortgages held in portfolio, the Credit Guaranty business charges the Portfolio Investment business a guaranty fee similar to what it would charge on an MBS. These "notional" guaranty fees are classified as net interest income for the Credit Guaranty business. Net interest income for the Credit Guaranty business also includes interest on capital invested in guaranty activities and income from temporary investment of principal and interest payments on guaranteed

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

mortgages prior to remittance to investors, and it is net of interest charges paid to the Portfolio Investment business for delinquent loans.

Fannie Mae assigns actual direct revenues and expenses among its lines of business and uses estimates to apportion overhead and other corporate items. For instance, administrative expenses are allocated on the basis of direct expenses for the line of business or, where not assignable to a particular associated business, are based on revenues, profits, or volumes, as applicable. Capital is allocated to the lines of business through an assessment of the interest rate and credit risk associated with each business.

The following table sets forth Fannie Mae's financial performance by line of business for the years ended December 31, 2000, 1999, and 1998.

	2000			1999			1998 (1)		
	Portfolio Investment	Credit Guaranty	Total	Portfolio Investment	Credit Guaranty	Total	Portfolio Investment	Credit Guaranty	Total
	(Dollars in millions)								
Net interest income	\$ 5,055	\$ 619	\$ 5,674	\$4,317	\$ 577	\$ 4,894	\$3,460	\$ 650	\$ 4,110
Guaranty fee income	(1,079)	2,430	1,351	(974)	2,256	1,282	(823)	2,052	1,229
Fee and other income (expense) . .	27	(71)	(44)	120	71	191	158	117	275
Credit-related expenses	—	(94)	(94)	—	(127)	(127)	—	(261)	(261)
Administrative expenses	(254)	(651)	(905)	(233)	(567)	(800)	(184)	(524)	(708)
Federal income taxes	(1,036)	(530)	(1,566)	(906)	(613)	(1,519)	(707)	(494)	(1,201)
Extraordinary item—gain (loss) on early extinguishment of debt	32	—	32	(9)	—	(9)	(26)	—	(26)
Net income	\$ 2,745	\$1,703	\$ 4,448	\$2,315	\$1,597	\$ 3,912	\$1,878	\$1,540	\$ 3,418

(1) Results include the recognition of additional non-recurring tax benefits associated with investments qualifying for low-income housing tax credits and additional amortization of premiums or discounts and deferred or prepaid guaranty fees that were recorded in the fourth quarter of 1998.

11. Dividend Restrictions

Fannie Mae's payment of dividends is subject to certain statutory restrictions, including approval of the Director of the Office of Federal Housing Enterprise Oversight of any dividend payment that would cause Fannie Mae's capital to fall below specified capital levels.

Fannie Mae has exceeded the applicable capital standard since the adoption of these restrictions in 1992 and, consequently, has been making dividend payments without the need for Director approval.

Payment of dividends on common stock is also subject to payment of dividends on preferred stock outstanding.

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

12. Preferred Stock

The following table presents preferred stock outstanding as of December 31, 2000 and 1999.

	Issue Date	Shares Issued and Outstanding	Stated Value per Share	Annual Dividend Rate	Redeemable on or After
Series A (1)	March 1, 1996	7,500,000	\$50	6.41%	March 1, 2001
Series B	April 12, 1996	7,500,000	50	6.50	April 12, 2001
Series C	September 20, 1996	5,000,000	50	6.45	September 20, 2001
Series D	September 30, 1998	3,000,000	50	5.25	September 30, 1999
Series E	April 15, 1999	3,000,000	50	5.10	April 15, 2004
Series F	March 20, 2000	13,800,000	50	6.30(2)	March 31, 2002(4)
Series G	August 8, 2000	<u>5,750,000</u>	50	6.02(3)	September 30, 2002(4)
Total		<u>45,550,000</u>			

- (1) Fannie Mae redeemed all of the outstanding shares of its 6.41 percent Series A preferred stock on March 1, 2001 at \$50.53 per share. The redemption price included dividends of \$.53417 per share for the period commencing December 31, 2000, up to, but excluding, March 1, 2001.
- (2) Initial rate. Variable dividend rate that resets every two years thereafter at the Constant Maturity Treasury Rate minus .16 percent with a cap of 11 percent per year.
- (3) Initial rate. Variable dividend rate that resets every two years thereafter at the Constant Maturity Treasury Rate minus .18 percent with a cap of 11 percent per year.
- (4) Initial call date and every two years thereafter.

Holders of preferred stock are entitled to receive noncumulative, quarterly dividends when, and if, declared by Fannie Mae's Board of Directors. Payment of dividends on preferred stock is not mandatory, but has priority over payment of dividends on common stock. After the specified period, preferred stock is redeemable at its stated value at the option of Fannie Mae. All outstanding preferred stock is nonvoting.

13. Financial Instruments with Off-Balance-Sheet Risk

Fannie Mae is a party to transactions involving financial instruments with off-balance-sheet risk. Fannie Mae uses these instruments to fulfill its statutory purpose of meeting the financing needs of the secondary mortgage market and to reduce its own exposure to fluctuations in interest rates. These financial instruments include guaranteed MBS, commitments to purchase mortgages or to issue and guarantee MBS, certain hedging instruments, and credit enhancements. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recognized on the balance sheet.

Guaranteed Mortgage-Backed Securities

As issuer and guarantor of MBS, Fannie Mae is obligated to disburse scheduled monthly installments of principal and interest (at the certificate rate) and the full UPB of any foreclosed mortgage to MBS investors, whether or not any such amounts have been received. Fannie Mae is also obligated to disburse unscheduled principal payments received from borrowers.

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

Fannie Mae's credit risk is mitigated to the extent that sellers of pools of mortgages elect to remain at risk for the loans sold to the company or other credit enhancement, such as recourse, is provided to protect against the risk of loss from borrower default. Lenders have the option to retain the primary default risk, in whole or in part, in exchange for a lower guaranty fee. Fannie Mae, however, bears the ultimate risk of default.

Commitments

Fannie Mae enters into master delivery commitments with lenders on either a mandatory or an optional basis. Under a mandatory master commitment, a lender must either deliver loans under an MBS contract at a specified guaranty fee rate or enter into a mandatory portfolio commitment with the yield established upon executing the portfolio commitment.

Fannie Mae will also accept mandatory or lender-option delivery commitments not issued pursuant to a master commitment. These commitments may be for portfolio or MBS. The guaranty fee rate on MBS lender-option commitments is specified in the contract, while the yield for portfolio lender-option commitments is set at the date of conversion to a mandatory commitment.

The cost of funding future portfolio purchases generally is hedged upon issuance of, or conversion to, a mandatory commitment. Therefore, the interest rate risk relating to loans purchased pursuant to those commitments is largely mitigated.

Hedging Instruments

Fannie Mae typically uses derivative instruments, such as those that simulate short sales of U.S. Treasury and agency securities, interest rate swaps, swaptions, interest rate caps, and deferred rate-setting agreements to hedge against interest rate movements. Changes in the value of these hedging instruments caused by fluctuations in interest rates are expected to offset changes in the value of the items hedged. Consequently, the primary risks associated with these hedging instruments are (1) interest rate risk—changes in the value of the item hedged will not substantially offset changes in the value of the hedging instrument; and, (2) credit risk—the counterparty to the agreement will be unable or unwilling to meet the terms of the agreement.

Credit risk on derivative instruments that simulate short sales of U.S. Treasury and agency securities arises from the possible inability or unwillingness of the counterparty to pay any difference between the agreed-upon price and the current price for the referenced securities at settlement. This risk is reduced through evaluation of the creditworthiness of counterparties and continuous monitoring of hedge positions. There were no deferrable net unrealized amounts on open hedge positions at December 31, 2000, compared with \$46 million of net unrealized gains at December 31, 1999. Total deferred gains and losses on closed positions were \$449 million and \$729 million, respectively, at December 31, 2000, compared with \$392 million and \$541 million, respectively, at December 31, 1999.

Fannie Mae reduces credit risk on interest rate swaps, swaptions, and interest rate caps by dealing only with experienced counterparties of high credit quality, diversifying these derivative instruments across counterparties, and ensuring that these derivative instruments generally are executed under master agreements that provide for netting of certain amounts payable by each party. Fannie Mae regularly monitors the exposures on its derivative instruments by valuing the positions via dealer quotes and internal pricing models. In addition, counterparties are obligated to post collateral if Fannie Mae is exposed to credit loss on the related derivative instruments exceeding an agreed-upon threshold. The amount of required collateral is based on counterparty credit ratings and the level of credit exposure. Fannie Mae generally requires overcollateralization from counterparties whose credit

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

ratings have dropped below predetermined levels. Fannie Mae held \$70 million of collateral through custodians for derivative instruments at December 31, 2000.

At December 31, 2000, over 99 percent of both the notional amount of Fannie Mae's outstanding derivative transactions and Fannie Mae's gross off-balance-sheet derivatives exposure were with counterparties rated A or better by Standard & Poor's. At December 31, 2000, nine counterparties represented approximately 86 percent of the total notional amount of outstanding derivative transactions, and each had a credit rating of A or better. At December 31, 2000, five counterparties comprised approximately 99 percent of gross off-balance-sheet exposure on derivatives, and each had a credit rating of A or better.

Credit risk on deferred rate-setting arrangements is limited to the cash receivable, if any, due from counterparties under the deferred rate-setting agreement. This risk is reduced through evaluating the creditworthiness of counterparties.

Credit Enhancements

Fannie Mae provides credit enhancement and, in some cases, liquidity support for certain financings involving taxable or tax-exempt housing bonds issued by state and local governmental entities to finance multifamily housing for low- and moderate-income families. In these transactions, Fannie Mae issues MBS, pledges an interest in certain mortgages it owns, or otherwise provides contractual assurance of payment to a trustee for the bonds or another credit party in the transaction. Fannie Mae's direct credit enhancement in a multifamily housing bond transaction improves the rating on the bond, thus resulting in lower-cost financing for multifamily housing.

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

Credit Exposure for Off-Balance-Sheet Financial Instruments

The following table presents the contractual or notional amount of off-balance-sheet financial instruments at December 31, 2000 and 1999.

	<u>2000</u>	<u>1999</u>
	(Dollars in billions)	
<u>Contractual amounts:</u>		
MBS outstanding(1)	\$1,057.2	\$ 960.3
MBS in portfolio	(351.1)	(281.7)
Net MBS outstanding(1)	<u>\$ 706.1</u>	<u>\$ 678.6</u>
<u>Master commitments:</u>		
Mandatory	\$ 25.3	\$ 46.5
Optional	9.7	17.4
<u>Portfolio commitments:</u>		
Mandatory	15.7	6.6
Optional	1.9	1.7
Other investments	1.9	1.5
<u>Notional amounts(2):</u>		
Interest rate swaps(3)	\$ 161.1	\$ 139.0
Debt swaps(4)	66.4	51.6
Interest rate caps	33.7	28.9
U.S. Treasury repurchase agreement options	—	20.0
Swaptions	48.9	19.2
Forward rate agreements	—	1.4
Simulated short sales of U.S. Treasury securities	—	1.2
Other .....	.2	2.2
Credit enhancements	8.6	7.2
Other guarantees	4.8	3.5

- (1) Net of \$603 million in allowance for losses in 2000 and \$604 million in 1999. Includes \$223 billion and \$209 billion of MBS with lender or third-party recourse at December 31, 2000 and 1999, respectively.
- (2) Notional amounts do not necessarily represent the interest rate or credit risk of the positions.
- (3) The weighted-average interest rate being received under these swaps was 6.78 percent and the weighted-average interest rate being paid was 6.74 percent at December 31, 2000, compared with 6.04 percent and 6.56 percent, respectively, at December 31, 1999.
- (4) The weighted-average interest rate being received under these swaps was 6.58 percent and the weighted-average interest rate being paid was 6.59 percent at December 31, 2000, compared with 5.72 percent and 5.90 percent, respectively, at December 31, 1999.

Contractual or notional amounts do not necessarily represent the interest rate or credit risk of the derivative instrument positions. The notional amounts of the derivative instruments are used to calculate contractual cash flows to be exchanged. In addition, any measurement of risk is meaningful

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

only to the extent that offsetting arrangements, such as master netting agreements and the value of related collateral, are included.

Fannie Mae's exposure to credit loss for derivative instruments can be estimated by calculating the cost, on a present value basis, to replace at current market rates all those derivative instruments outstanding for which the company was in a gain position. Fannie Mae's net exposure (taking into account master netting agreements) was \$.2 billion at December 31, 2000 and \$3.9 billion at December 31, 1999. Fannie Mae expects the net credit exposure to fluctuate as interest rates change.

14. Concentrations of Credit Risk

Concentrations of credit risk exist when a significant number of counterparties (e.g., borrowers, lenders, and mortgage insurers) engage in similar activities or are susceptible to similar changes in economic conditions that could affect their ability to meet contractual obligations.

The following table presents the regional geographic distribution of properties underlying mortgages in the portfolio and underlying MBS outstanding by primary default risk at December 31, 2000 and 1999.

<u>2000</u>	<u>Gross UPB</u> (Dollars in millions)	<u>Geographic Distribution</u>					<u>Total</u>
		<u>Northeast</u>	<u>Southeast</u>	<u>Midwest</u>	<u>Southwest</u>	<u>West</u>	
Fannie Mae risk	\$1,049,657	19%	20%	19%	16%	26%	100%
Lender or shared risk	<u>267,149</u>	<u>14</u>	<u>20</u>	<u>22</u>	<u>17</u>	<u>27</u>	<u>100</u>
Total	<u>\$1,316,806</u>	<u>19%</u>	<u>20%</u>	<u>19%</u>	<u>16%</u>	<u>26%</u>	<u>100%</u>

<u>1999</u>	<u>Gross UPB</u> (Dollars in millions)	<u>Geographic Distribution</u>					<u>Total</u>
		<u>Northeast</u>	<u>Southeast</u>	<u>Midwest</u>	<u>Southwest</u>	<u>West</u>	
Fannie Mae risk	\$ 952,005	20%	20%	19%	15%	26%	100%
Lender or shared risk	<u>251,105</u>	<u>15</u>	<u>20</u>	<u>23</u>	<u>16</u>	<u>26</u>	<u>100</u>
Total	<u>\$1,203,110</u>	<u>19%</u>	<u>20%</u>	<u>19%</u>	<u>16%</u>	<u>26%</u>	<u>100%</u>

No significant concentration existed at the state level at December 31, 2000, except for California where 18 percent of the gross UPB of mortgages in portfolio and underlying MBS were located, the same level as December 31, 1999.

To minimize credit risk, Fannie Mae requires primary mortgage insurance or other credit protection if the loan-to-value (LTV) ratio of a single-family conventional mortgage loan (the UPB of the loan divided by the value of the mortgaged property) is greater than 80 percent when the loan is delivered to Fannie Mae.

At December 31, 2000, \$302 billion in current UPB of single-family conventional mortgage loans in portfolio and underlying MBS outstanding was covered by primary insurance at acquisition. Seven mortgage insurance companies, all rated AA or higher by Standard & Poor's, provided approximately 98 percent of the total coverage. Fannie Mae monitors the performance and financial strength of its mortgage insurers on a regular basis.

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

The following table presents the distribution of single-family loans in portfolio and underlying MBS outstanding by original LTV and primary default risk at December 31, 2000 and 1999.

<u>2000</u>	<u>Gross UPB</u> (Dollars in millions)	<u>Original Loan-to-Value Ratio</u>					<u>Over 90%</u>	<u>Total</u>
		<u>60% or less</u>	<u>61–70%</u>	<u>71–75%</u>	<u>76–80%</u>	<u>81–90%</u>		
Fannie Mae risk	\$1,003,068	19%	15%	15%	26%	14%	11%	100%
Lender or shared risk . .	<u>208,464</u>	<u>5</u>	<u>8</u>	<u>11</u>	<u>34</u>	<u>22</u>	<u>20</u>	<u>100</u>
Total	<u>\$1,211,532</u>	<u>16%</u>	<u>14%</u>	<u>15%</u>	<u>27%</u>	<u>15%</u>	<u>13%</u>	<u>100%</u>

<u>1999</u>	<u>Gross UPB</u> (Dollars in millions)	<u>Original Loan-to-Value Ratio</u>					<u>Over 90%</u>	<u>Total</u>
		<u>60% or less</u>	<u>61–70%</u>	<u>71–75%</u>	<u>76–80%</u>	<u>81–90%</u>		
Fannie Mae risk	\$ 912,458	20%	16%	16%	24%	13%	11%	100%
Lender or shared risk . .	<u>194,931</u>	<u>5</u>	<u>8</u>	<u>12</u>	<u>34</u>	<u>22</u>	<u>19</u>	<u>100</u>
Total	<u>\$1,107,389</u>	<u>17%</u>	<u>15%</u>	<u>15%</u>	<u>26%</u>	<u>15%</u>	<u>12%</u>	<u>100%</u>

The rate at which mortgage loans prepay tends to be sensitive to the level and direction of prevailing market interest rates. In a declining interest rate environment, higher-rate mortgage loans will pay off at a faster rate. Conversely, in an increasing interest rate environment, lower-rate mortgage loans will prepay at a slower rate. The following table presents the distribution of fixed-rate, single-family loans in the mortgage portfolio or underlying MBS by note rate at December 31, 2000 and 1999.

<u>Gross UPB at December 31,</u>	<u>Fixed-Rate Loans by Note Rate (1)</u>					<u>Total</u>
	<u>Under 7.00%</u>	<u>7.00% to 7.99%</u>	<u>8.00% to 8.99%</u>	<u>9.00% to 9.99%</u>	<u>10.00% and over</u>	
	(Dollars in billions)					
<u>2000</u>	\$285	\$536	\$218	\$28	\$10	\$1,077
Percent of total	26%	50%	20%	3%	1%	100%
<u>1999</u>	\$312	\$530	\$130	\$22	\$11	\$1,005
Percent of total	31%	53%	13%	2%	1%	100%

(1) Excludes housing revenue bonds and non-Fannie Mae securities.

15. Disclosures of Fair Value of Financial Instruments

The basic assumptions used and the estimates disclosed in the Fair Value Balance Sheets represent management’s best judgment of appropriate valuation methods. These estimates are based on pertinent information available to management as of December 31, 2000 and 1999. In certain cases, fair values are not subject to precise quantification or verification and may change as economic and market factors, and management’s evaluation of those factors, change.

Although management uses its best judgment in estimating the fair value of these financial instruments, there are inherent limitations in any estimation technique. Therefore, these fair value estimates are not necessarily indicative of the amounts that Fannie Mae would realize in a market transaction. The accompanying Fair Value Balance Sheets do not represent an estimate of the overall

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

Notes to Fair Value Balance Sheets

The following discussion summarizes the significant methodologies and assumptions used in estimating the fair values presented in the accompanying Fair Value Balance Sheets.

Mortgage Portfolio, Net

The fair value calculations of Fannie Mae's mortgage portfolio considered such variables as interest rates, credit quality, and loan collateral. Because an active market does not exist for a portion of mortgage loans in the portfolio, the portfolio's unsecuritized mortgages were aggregated into pools by product type, coupon, and maturity and converted into notional MBS. A normal guaranty fee that Fannie Mae's securitization business would charge for a pool of loans with similar characteristics was subtracted from the weighted-average coupon rate less servicing fees. The method for estimating this guaranty fee and the credit risk associated with the mortgage portfolio is described under "Guaranty Fee Income, Net."

Fannie Mae then employed an option-adjusted spread (OAS) approach to estimate fair values for both notional MBS and MBS held in portfolio. The OAS approach represents the risk premium or incremental interest spread over Fannie Mae debt rates that is included in a security's yield to compensate an investor for the uncertain effects of embedded prepayment options on mortgages. The OAS was calculated using quoted market values for selected benchmark securities and provided a generally applicable return measure that considers the effect of prepayment risk and interest rate volatility.

Investments

Fair values of Fannie Mae's investment portfolio were based on actual quoted prices or prices quoted for similar financial instruments.

Cash and Cash Equivalents

The carrying amount of cash and cash equivalents was used as a reasonable estimate of their fair value.

Other Assets

Other assets include accrued interest receivable, net currency swap receivables, and several other smaller asset categories. The fair value of other assets, excluding certain deferred items that have no fair value and net currency swap receivables, approximates their carrying amount. The fair value of net currency swap receivables was estimated based on either the expected cash flows or quoted market values of these instruments.

Guaranty Fee Income, Net

MBS are not assets owned by Fannie Mae, except when acquired for investment purposes, nor are MBS recorded as liabilities of Fannie Mae. Fannie Mae receives a guaranty fee calculated on the outstanding principal balance of the related mortgages for guaranteed MBS held by third-party investors. The guaranty fee represents a future income stream for Fannie Mae. Under generally accepted accounting principles, this guaranty fee is recognized as income over the life of the securities. The Fair Value Balance Sheets reflect the present value of guaranty fees, net of estimated future administrative costs and credit losses, and taking into account estimated prepayments.

FANNIE MAE

NOTES TO FINANCIAL STATEMENTS—(Continued)

Fannie Mae estimates the credit loss exposure attached to the notional amount of guaranteed MBS held by third-party investors where Fannie Mae has the primary risk of default. Fannie Mae deducts estimated credit losses from the projected guaranty fee cash flows to arrive at the fair value. Estimated credit losses were calculated with an internal forecasting model based on actual historical loss experience for the company. The net guaranty fee cash flows were then valued through an OAS method similar to that described under “Mortgage Portfolio, Net.”

Swap Obligations, Net

Fannie Mae enters into interest rate swaps, including callable swaps that, in general, extend or adjust the effective maturity of certain debt obligations. Under these swaps, Fannie Mae generally pays a fixed rate and receives a floating rate based on a notional amount. Fannie Mae also enters into interest rate swaps that are linked to specific investments (asset swaps) or specific debt issues (debt swaps). The fair value of interest rate swaps was estimated based on either the expected cash flows or quoted market values of these instruments. The effect of netting under master agreements was included in determining swap obligations in a gain position or loss position.

In addition, Fannie Mae enters into swaptions and interest rate caps. Under a swaption, Fannie Mae has the option to enter into a swap, as described above, at a future date. Fannie Mae uses interest rate caps to effectively manage its interest expense in a period of rising interest rates by entering into an agreement whereby a counterparty makes payments to the company for interest rates above a specified rate. The fair values of these derivative instruments were estimated based on either the expected cash flows or the quoted market values of these instruments.

Noncallable and Callable Debt

The fair value of Fannie Mae’s noncallable debt was estimated by using quotes for selected debt securities of the company with similar terms. Similar to the valuation of the mortgage portfolio, the fair value of callable debt was estimated with an OAS model.

Other Liabilities

Other liabilities include accrued interest payable, amounts payable to MBS holders, estimated losses on guaranteed MBS, net currency swap payables, and several other smaller liability categories. The fair value of other liabilities, excluding certain deferred items that have no fair value, net currency swap payables, and credit loss exposure for guaranteed MBS, which is included as a component of the net MBS guaranty fee, approximates their carrying amount. The fair value of net currency swap payables was estimated based on either the expected cash flows or quoted market values of these instruments.

The fair value amount also includes the estimated effect on deferred income taxes of providing for federal income taxes for the difference between net assets at fair value and at cost at the statutory corporate tax rate of 35 percent.

FANNIE MAE

QUARTERLY RESULTS OF OPERATIONS (Unaudited)

The following unaudited results of operations include, in the opinion of management, all adjustments necessary for a fair presentation of the results of operations for such periods.

	2000 Quarter Ended			
	<u>December</u>	<u>September</u>	<u>June</u>	<u>March</u>
	(Dollars in millions, except per common share amounts)			
Interest income	\$11,581	\$10,862	\$10,365	\$9,973
Interest expense	<u>10,096</u>	<u>9,434</u>	<u>8,966</u>	<u>8,611</u>
Net interest income	1,485	1,428	1,399	1,362
Guaranty fee income	339	341	339	332
Fee and other income (expense)	1	1	(46)	—
Provision for losses	30	30	30	30
Foreclosed property expenses	(51)	(52)	(51)	(60)
Administrative expenses	<u>(232)</u>	<u>(232)</u>	<u>(224)</u>	<u>(217)</u>
Income before federal income taxes and extraordinary item	1,572	1,516	1,447	1,447
Provision for federal income taxes	<u>(405)</u>	<u>(393)</u>	<u>(383)</u>	<u>(385)</u>
Income before extraordinary item	1,167	1,123	1,064	1,062
Extraordinary item—(loss) gain on early extinguishment of debt, net of tax effect	<u>(2)</u>	<u>1</u>	<u>33</u>	<u>—</u>
Net income	<u>\$ 1,165</u>	<u>\$ 1,124</u>	<u>\$ 1,097</u>	<u>\$1,062</u>
Preferred stock dividends	<u>(36)</u>	<u>(33)</u>	<u>(32)</u>	<u>(20)</u>
Net income available to common stockholders	<u>\$ 1,129</u>	<u>\$ 1,091</u>	<u>\$ 1,065</u>	<u>\$1,042</u>
Basic earnings per common share(1):				
Earnings before extraordinary item	\$ 1.13	\$ 1.09	\$ 1.03	\$ 1.03
Extraordinary gain	<u>—</u>	<u>—</u>	<u>.03</u>	<u>—</u>
Net earnings	<u>\$ 1.13</u>	<u>\$ 1.09</u>	<u>\$ 1.06</u>	<u>\$ 1.03</u>
Diluted earnings per common share(1):				
Earnings before extraordinary item	\$ 1.13	\$ 1.09	\$ 1.02	\$ 1.02
Extraordinary (loss) gain	<u>(.01)</u>	<u>—</u>	<u>.03</u>	<u>—</u>
Net earnings	<u>\$ 1.12</u>	<u>\$ 1.09</u>	<u>\$ 1.05</u>	<u>\$ 1.02</u>
Cash dividends per common share	\$.28	\$.28	\$.28	\$.28

(1) The total of the four quarters may not equal the amount for the year because the amount for each period is calculated independently based on the weighted-average number of common shares outstanding during the period.

FANNIE MAE

QUARTERLY RESULTS OF OPERATIONS (Unaudited) — (continued)

The following unaudited results of operations include, in the opinion of management, all adjustments necessary for a fair presentation of the results of operations for such periods.

	1999 Quarter Ended			
	<u>December</u>	<u>September</u>	<u>June</u>	<u>March</u>
	<small>(Dollars in millions, except per common share amounts)</small>			
Interest income	\$9,569	\$9,079	\$8,564	\$8,283
Interest expense	<u>8,263</u>	<u>7,838</u>	<u>7,376</u>	<u>7,124</u>
Net interest income	1,306	1,241	1,188	1,159
Guaranty fee income	325	320	320	317
Fee and other income	45	34	54	58
Provision for losses	35	40	25	20
Foreclosed property expenses	(54)	(61)	(65)	(67)
Administrative expenses	<u>(206)</u>	<u>(203)</u>	<u>(199)</u>	<u>(192)</u>
Income before federal income taxes and extraordinary item	1,451	1,371	1,323	1,295
Provision for federal income taxes	<u>(413)</u>	<u>(380)</u>	<u>(365)</u>	<u>(361)</u>
Income before extraordinary item	1,038	991	958	934
Extraordinary item—loss on early extinguishment of debt, net of tax effect	<u>—</u>	<u>—</u>	<u>—</u>	<u>(9)</u>
Net income	<u>\$1,038</u>	<u>\$ 991</u>	<u>\$ 958</u>	<u>\$ 925</u>
Preferred stock dividends	<u>(20)</u>	<u>(20)</u>	<u>(20)</u>	<u>(18)</u>
Net income available to common stockholders	<u>\$1,018</u>	<u>\$ 971</u>	<u>\$ 938</u>	<u>\$ 907</u>
Basic earnings per common share(1):				
Earnings before extraordinary item	\$ 1.00	\$.95	\$.92	\$.89
Extraordinary loss	<u>—</u>	<u>—</u>	<u>—</u>	<u>(.01)</u>
Net earnings	<u>\$ 1.00</u>	<u>\$.95</u>	<u>\$.92</u>	<u>\$.88</u>
Diluted earnings per common share(1):				
Earnings before extraordinary item	\$.99	\$.94	\$.91	\$.88
Extraordinary loss	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net earnings	<u>\$.99</u>	<u>\$.94</u>	<u>\$.91</u>	<u>\$.88</u>
Cash dividends per common share	\$.27	\$.27	\$.27	\$.27

(1) The total of the four quarters may not equal the amount for the year because the amount for each period is calculated independently based on the weighted-average number of common shares outstanding during the period.

FANNIE MAE

NET INTEREST INCOME AND AVERAGE BALANCES (Unaudited)

	2000	1999	1998
	(Dollars in millions)		
Interest income:			
Mortgage portfolio	\$ 39,403	\$ 32,672	\$ 25,676
Investments and cash equivalents	3,378	2,823	4,319
Total interest income	42,781	35,495	29,995
Interest expense(1):			
Short-term debt	4,204	3,952	4,809
Long-term debt	32,903	26,649	21,076
Total interest expense	37,107	30,601	25,885
Net interest income	5,674	4,894	4,110
Taxable-equivalent adjustment(2)	414	341	304
Net interest income taxable-equivalent basis	\$ 6,088	\$ 5,235	\$ 4,414
Average balances:			
Interest-earning assets(3):			
Mortgage portfolio, net	\$553,531	\$468,320	\$352,169
Investments and cash equivalents	51,490	51,459	75,369
Total interest-earning assets	\$605,021	\$519,779	\$427,538
Interest-bearing liabilities(1):			
Short-term debt	\$ 73,351	\$ 81,028	\$ 89,890
Long-term debt	511,075	419,538	319,638
Total interest-bearing liabilities	584,426	500,566	409,528
Interest-free funds	20,595	19,213	18,010
Total interest-bearing liabilities and interest-free funds	\$605,021	\$519,779	\$427,538
Average interest rates(2)			
Interest-earning assets:			
Mortgage portfolio, net	7.16%	7.04%	7.38%
Investments and cash equivalents	6.60	5.52	5.76
Total interest-earning assets	7.11	6.89	7.09
Interest-bearing liabilities(1):			
Short-term debt	5.70	4.84	5.29
Long-term debt	6.44	6.35	6.60
Total interest-bearing liabilities	6.35	6.11	6.31
Investment spread(4) .....	.76	.78	.78
Interest-free return(5) .....	.25	.23	.25
Net interest margin(6)	1.01%	1.01%	1.03%

- (1) Classification of interest expense and interest-bearing liabilities as short-term or long-term is based on effective maturity or repricing date, taking into consideration the effect of derivative financial instruments.
- (2) Reflects pro forma adjustments to permit comparison of yields on tax-advantaged and taxable assets.
- (3) Includes average balance of nonperforming loans of \$2.1 billion in 2000, \$3.1 billion in 1999, and \$2.6 billion in 1998.
- (4) Consists primarily of the difference between the yield on interest-earning assets, adjusted for tax benefits of nontaxable income, and the effective cost of funds on interest-bearing liabilities.
- (5) Consists primarily of the return on that portion of the investment portfolio funded by equity and non-interest-bearing liabilities.
- (6) Net interest income, on a taxable-equivalent basis, as a percentage of the average mortgage and investment portfolios.

FANNIE MAE

RATE/VOLUME ANALYSIS (Unaudited)

	<u>Increase</u> <u>(Decrease)</u>	<u>Attributable to</u> <u>Changes in (1)</u>	
		<u>Volume</u>	<u>Rate</u>
	(Dollars in millions)		
<u>2000 vs. 1999</u>			
Interest income:			
Mortgage portfolio	\$ 6,731	\$ 6,053	\$ 678
Investments and cash equivalents	<u>555</u>	<u>2</u>	<u>553</u>
Total interest income	<u>7,286</u>	<u>6,055</u>	<u>1,231</u>
Interest expense(2):			
Short-term debt	252	(398)	650
Long-term debt	<u>6,254</u>	<u>5,889</u>	<u>365</u>
Total interest expense	<u>6,506</u>	<u>5,491</u>	<u>1,015</u>
Net interest income	<u>\$ 780</u>	<u>\$ 564</u>	<u>\$ 216</u>
 <u>1999 vs. 1998</u>			
Interest income:			
Mortgage portfolio	\$ 6,996	\$ 8,145	\$(1,149)
Investments and cash equivalents	<u>(1,496)</u>	<u>(1,319)</u>	<u>(177)</u>
Total interest income	<u>5,500</u>	<u>6,826</u>	<u>(1,326)</u>
Interest expense(2):			
Short-term debt	(857)	(452)	(405)
Long-term debt	<u>5,573</u>	<u>6,371</u>	<u>(798)</u>
Total interest expense	<u>4,716</u>	<u>5,919</u>	<u>(1,203)</u>
Net interest income	<u>\$ 784</u>	<u>\$ 907</u>	<u>\$ (123)</u>

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- (1) Combined rate/volume variances, a third element of the calculation, are allocated to the rate and volume variances based on their relative size.
 - (2) Classification of interest expense and interest-bearing liabilities as short-term or long-term is based on the effective maturity or repricing date, taking into consideration the effect of derivative financial instruments.

MANAGEMENT

Directors

The age and background, as of March 27, 2001, of each of the members of the Board of Directors of Fannie Mae 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>
Stephen B. Ashley, 61	Chairman and Chief Executive Officer, The Ashley Group, a group of commercial and multifamily real estate, brokerage and investment companies, since January 1997; Chairman and Chief Executive Officer, Sibley Mortgage Corporation, a mortgage banking company, from 1985 to 1996; Chairman and Chief Executive Officer, Sibley Real Estate Services, Inc., a property management company, 1985 to 1996.	1995	Exeter Fund, Inc.; The Genesee Corporation; Hahn Automotive Warehouse, Inc.; Manning & Napiers Insurance Fund, Inc.
Roger E. Birk, 70	Former President and Chief Operating Officer of Fannie Mae from November 1987 until his retirement in January 1992.	1985	
Kenneth M. Duberstein, 56	Chairman and Chief Executive Officer, The Duberstein Group, an independent strategic planning and consulting company, since July 1989; Chief of Staff to the President of the United States from 1988 to 1989.	1998	The Boeing Company; Conoco Inc.; Global Vacation Group; St. Paul Companies, Inc.
Stephen Friedman, 63	Senior Principal, Marsh McLennan Risk Capital Corp., an insurance brokerage, money management and consulting firm, since March 1998; Limited Partner since 1994, Senior Chairman from 1994 to 1998, and Co-Chairman or Chairman from 1990 to 1994, Goldman, Sachs & Co., an investment banking firm.	1996	Wal-Mart Stores, Inc.
Thomas P. Gerrity, 59	Professor of Management since 1990, Director since 1999 (Wharton Electronic Business Initiative), Dean from 1990 to 1999, The Wharton School of the University of Pennsylvania; President of CSC Consulting and Vice President of Computer Sciences Corporation from 1989 to 1990; Chairman and Chief Executive Officer, Index Group, a technology-oriented consulting company, from 1969 to 1989.	1991	CVS Corporation; Reliance Group Holdings, Inc.; Sunoco, Inc.; Knight-Ridder, Inc.; Internet Capital Group, Inc.; MAS Funds
Jamie S. Gorelick, 50	Vice Chair of Fannie Mae since May 1997; Deputy Attorney General of the United States from 1994 to 1997; General Counsel to the U.S. Department of Defense from 1993 to 1994; Partner, Miller, Cassidy, Larroca & Lewin, a law firm, from 1981 to 1993.	1997	United Technologies Corp.
Maynard Jackson, 63	Chairman of Jackson Securities Inc., a full service broker-dealer headquartered in Atlanta, Georgia, since 1990; Mayor of Atlanta from 1990 to 1994 and from 1974 to 1982.		
Vincent A. Mai, 60	Chairman since 1999, Chairman and Chief Executive Officer from 1998 to 1999 and President and Chief Executive Officer from 1989 to 1998 of AEA Investors Inc., a private investment company; Managing Director, Shearson Lehman Brothers, Inc., an investment banking firm, from 1974 to 1989.	1991	Dal-Tile International, Inc.

<u>Name and Age</u>	<u>Principal Occupation and Business Experience</u>	<u>First Became Director</u>	<u>Other Directorships (1)</u>
Gary Mauro, Esq.(2), 53	Attorney in private practice in Austin, Texas, since January 1999; Commissioner of the Texas General Land Office from 1983 to 1999.	1999	
Ann McLaughlin Korologos, 59	Chairman Emeritus since August 2000, Chairman from October 1996 to August 2000, Vice Chairman from 1993 to 1996, The Aspen Institute, a nonprofit organization; Senior Advisor, Benedetto, Gartland & Company, Inc., an investment banking firm; President of the Federal City Council, a nonprofit organization, from 1990 to 1995; Visiting Fellow, The Urban Institute, a nonprofit organization; Chairman, President's Commission on Aviation Security and Terrorism, from 1989 to 1990; U.S. Secretary of Labor from 1987 to 1989.	1994	AMR Corporation (and its subsidiary, American Airlines); Donna Karan International Inc.; Harman International Industries, Inc.; Host Marriott Corporation; Kellogg Company; Microsoft Corporation; Nordstrom Inc.; Vulcan Materials Company.
Daniel H. Mudd, 42	Vice Chairman and Chief Operating Officer of Fannie Mae since February, 2000; President and Chief Executive Officer of GE Capital, Japan from 1999 to 2000. He was with GE Capital, a diversified financial services company and subsidiary of General Electric Company, since 1991 in a variety of positions including President and Chief Executive Officer of GE Capital, Asia Pacific from 1996 to 1999.	2000	
Anne M. Mulcahy, 48	President and Chief Operating Officer since May 2000, President, General Markets Operations from January 1998 to May 2000, of the Xerox Corporation, a global company serving document processing markets. She has been with Xerox since 1976 in a variety of positions including Senior Vice President and Chief Staff Officer.	2000	Target Corporation; Xerox Corporation
Joe K. Pickett, 55	Chairman since February 2001, Chairman and Chief Executive Officer, from February 1996 to February 2001, HomeSide International, Inc. and Chairman of its subsidiary, HomeSide Lending, Inc. (successor entity to BancBoston Mortgage Corporation), a mortgage banking company, since 1990.	1996	
Jack Quinn(2), 51	Co-Chairman, Quinn Gillespie & Associates LLC, a strategic consulting firm, since January 2000; Partner, Arnold & Porter, a law firm, from 1982 to 1992 and from 1997 to 2000; Counsel to the President of the United States from 1995 to 1997; Chief of Staff and Counsel to the Vice President of the United States from 1993 to 1995.	1998	
Franklin D. Raines, 52	Chairman of the Board of Directors and Chief Executive Officer of Fannie Mae since January 1999; Chairman of the Board and Chief Executive Officer-Designate, from May 1998 to December 1998; Director, U.S. Office of Management and Budget, from 1996 to 1998; Vice Chairman of Fannie Mae, from 1991 to 1996.	1991	AOL Time Warner Inc.; Pfizer Inc.; Pepsico, Inc.

<u>Name and Age</u>	<u>Principal Occupation and Business Experience</u>	<u>First Became Director</u>	<u>Other Directorships (1)</u>
Eli J. Segal(2), 58	Chairman of Steering Committee since December 2000, President and Chief Executive Officer from February 1997 to December 2000, The Welfare to Work Partnership, a nonprofit organization; Assistant to the President of the United States and CEO of the Corporation for National Service (AmeriCorp) from 1993 to 1996.	1997	Hasbro, Inc., Hotel Reservations Network
H. Patrick Swygert, 58	President of Howard University since 1995. President of the State University of New York at Albany from 1995 to 1999.	1999	The Hartford Financial Services Group, Inc.; The Victory Funds
Esteban Torres(2), 71	Economic Development Consultant; Member of the U.S. House of Representatives, California 34th Congressional District from 1982 to 1998.		

(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. Certain directorships of other companies also are noted in the principal occupation column.

(2) Appointed by the President of the United States, who has authority to appoint five directors.

The term of each director will end on the date of the May 2001 annual meeting of stockholders, except that the President of the United States may remove any director that the President appointed for good cause.

Executive Officers

The age and business experience, as of March 27, 2001, of each of the executive officers of Fannie Mae, are as follows:

Franklin D. Raines, 52, has been Chairman of the Board of Directors and Chief Executive Officer since January 1999. Mr. Raines was Chairman of the Board and Chief Executive Officer-Designate from May 1998 to December 1998. Mr. Raines was Director, Office of Management and Budget from September 1996 to May 1998, and Vice Chairman of Fannie Mae from September 1991 to August 1996.

Daniel H. Mudd, 42, has been Vice Chairman and Chief Operating Officer since February 2000. Mr. Mudd was with GE Capital from 1991 to 2000 in a variety of positions including, most recently, President and Chief Executive Officer of GE Capital, Japan, from 1999 to 2000 and of GE Capital, Asia Pacific, from 1996 to 1999.

Jamie S. Gorelick, 50, has been Vice Chair since May 1997. Ms. Gorelick was Deputy Attorney General of the United States from March 1994 to April 1997. Ms. Gorelick served as General Counsel to the United States Department of Defense from May 1993 to March 1994.

J. Timothy Howard, 52, has been Executive Vice President and Chief Financial Officer since February 1990.

Thomas E. Donilon, 45, has been Executive Vice President—Law and Policy since May 2000. He was Senior Vice President, General Counsel and Secretary from September 1999 to May 2000. Mr. Donilon was a partner with the law firm of O'Melveny & Myers from 1991 to 1993 and 1997 to 1999. He was Assistant Secretary of State for Public Affairs and Chief of Staff to the Secretary of State from 1993 to 1996.

Louis W. Hoyes, 52, has been Executive Vice President—Single Family Mortgage Business since May, 2000. Mr. Hoyes was Senior Vice President—Multifamily Lending and Investment from July 1995 to May 2000. Prior to his employment with Fannie Mae, Mr. Hoyes was with Citicorp Real

Estate from 1982 until 1995, in various positions, including a managing director of the residential segment of Citicorp's real estate business in North America.

Robert J. Levin, 45, has been Executive Vice President—Housing and Community Development since June 1998. Mr. Levin was Executive Vice President—Marketing from June 1990 to June 1998.

Adolfo Marzol, 40, has been Executive Vice President and Chief Credit Officer since July 1998. Mr. Marzol was Senior Vice President—Single-Family Business Management from July 1996 to July 1998. Mr. Marzol was Senior Vice President—Capital Markets from February 1996 to July 1996.

Julie St. John, 49, has been Executive Vice President and Chief Technology Officer since July 2000. She was Senior Vice President—Mortgage Business Technology (previously Senior Vice President—Guaranty and Franchise Technologies and Senior Vice President of Transaction Processing and Management Systems) from June 1993 to July 2000.

Kenneth J. Bacon, 46, has been Senior Vice President—Multifamily Lending and Investment since November 2000. He was Senior Vice President—American Communities Fund from September 1998 to November 2000 and Senior Vice President—Northeastern Regional Office from April 1993 to September 1998.

Ann M. Kappler, 44, has been Senior Vice President and General Counsel since May 2000. Ms. Kappler was Senior Vice President and Deputy General Counsel from January 1999 to May 2000 and a partner in the law firm of Jenner & Block from 1994 to 1998.

Linda K. Knight, 51, has been Senior Vice President and Treasurer since February 1993.

Thomas A. Lawler, 48, has been Senior Vice President—Portfolio Management since November 1989.

Thomas A. Lund, 42, has been Senior Vice President—Investor Channel since August 2000. Mr. Lund was Senior Vice President—Southwestern Regional Office from July 1996 to August 2000 and Vice President—Marketing in the Southwestern Regional Office from January 1995 to July 1996.

Peter Niculescu, 41, has been Senior Vice President—Portfolio Strategy since March 1999. Prior to his employment with Fannie Mae, Mr. Niculescu was a Managing Director and Co-Head of Fixed Income Research for Goldman Sachs. He joined Goldman Sachs in 1990 and held a variety of positions including Managing Director—Mortgage Research, Vice President—Mortgage Research and Corporate Bond Strategist.

Thomas R. Nides, 40, has been Senior Vice President—Administration since July 2000. He was Senior Vice President—Human Resources from November 1997 to July 2000 and was Vice President—Human Resources from May 1997 to November 1997. Mr. Nides was a Principal with Morgan Stanley from April 1996 to May 1997. Mr. Nides was Fannie Mae's Vice President—Housing Impact from January 1995 to April 1996.

Michael A. Quinn, 46, has been Senior Vice President—Single Family Mortgage Business since June 1998. He was Senior Vice President—Credit Loss Management from April 1994 to June 1998. Mr. Quinn was Senior Vice President and Controller from March 1991 to April 1994.

Michael J. Williams, 43, has been President—Fannie Mae e-Business since January 2001. He was Senior Vice President—e-commerce from February 2000 to January 2001 and Senior Vice President—Customer Applications and Technology Integration from 1993 to 2000.

Additional Information

For information concerning executive compensation, stock ownership of management and directors, certain transactions of executive officers, and any person or group owning more than five percent of the voting stock of Fannie Mae, reference is made to the proxy statement for Fannie Mae's 2001 annual meeting of stockholders and any later proxy statement published prior to Fannie Mae's

publication of a new Information Statement, which are incorporated herein by this reference. The proxy statement for Fannie Mae's 2001 annual meeting of stockholders will be available in April 2001.

Fannie Mae will provide without charge a copy of Fannie Mae's most recent proxy statement to each person to whom this Information Statement has been delivered, upon the written or oral request of such person. Requests for such copies should be directed to the office specified on page 2 of this Information Statement.



8,000,000 Shares



5.81% Non-Cumulative Preferred Stock, Series H
(stated value \$50 per share)

OFFERING CIRCULAR

Bear, Stearns & Co. Inc.

Lehman Brothers

First Tennessee Bank N.A.

Merrill Lynch & Co.

Ormes Capital Markets, Inc.
