Information Statement

This Information Statement describes the business and operations of the Federal National Mortgage Association (''Fannie Mae'' or the ''Corporation'') as of March 31, 1997 and its financial condition as of December 31, 1996.

In connection with offerings of securities, the Corporation distributes Offering Circulars or Prospectuses 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 Corporation's current Information Statement, any supplements thereto and other available information from the office listed on page 2.

This Information Statement contains Fannie Mae's audited financial statements for the year ended December 31, 1996. 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.

The Corporation's securities are not required to be registered under the Securities Act of 1933. At the close of business on February 28, 1997, approximately 1,064 million shares of the Corporation's common stock (without par value) were outstanding.

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

March 31, 1997

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DOCUMENTS INCORPORATED BY REFERENCE

Fannie Mae's Proxy Statement for the 1996 Annual Meeting of Shareholders is incorporated by reference herein under ''Management—Additional Information.'' Any later proxy statement published by Fannie Mae prior to the publication of a new Information Statement 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 hereto. 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 the Corporation in this Information Statement.

AVAILABLE INFORMATION

The Corporation periodically makes available statistical information on its mortgage purchase and mortgage-backed securities volumes as well as other relevant information about the Corporation. You may obtain copies of this Information Statement, any supplements relating hereto, as well as the Corporation's annual and quarterly reports to stockholders, the Federal National Mortgage Association Charter Act, the Corporation's bylaws and other information regarding the Corporation without charge from the Office of Investor Relations, Fannie Mae, 3900 Wisconsin Avenue, NW, Washington, DC 20016 (telephone (202/752-7115). You may inspect reports and other information concerning the Corporation at the offices of the New York Stock Exchange, the Chicago Stock Exchange and the Pacific Stock Exchange. Fannie Mae does not file reports or other information with the Securities and Exchange Commission.

BUSINESS

General

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

The Corporation provides funds to the mortgage market by purchasing mortgage loans from lenders, thereby replenishing their funds for additional lending. The Corporation 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, the Corporation is able to expand the total amount of funds available for housing.

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

In addition, the Corporation offers various services to lenders and others for a fee. These services include issuing certain types of MBS and providing technology services for originating and underwriting loans.

For information regarding the Corporation's mortgage loan, MBS and other activities in 1996, 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.'' (The Corporation purchases participation interests that range from 50 to 99 percent.) The term ''mortgage'' also is used to refer to the security instrument securing a loan rather than the loan itself, and when so used also refers to a deed of trust. 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

The Corporation purchases primarily single-family, conventional (i.e., not federally insured or guaranteed), fixed- or adjustable-rate, first mortgage loans, but it also purchases other types of residential mortgage loans for its loan portfolio, including mortgage loans insured by the Federal Housing Administration (''FHA''), mortgage loans guaranteed by the Department of Veterans Affairs (''VA''), mortgage loans guaranteed by the Rural Housing Service, multifamily mortgage loans and second mortgage loans (*i.e.*, loans secured by second liens). The Corporation's purchases have a variety of maturities. The Corporation's purchases of adjustable-rate mortgage loans (''ARMs''), fixed-rate loans with intermediate terms of 20 years or less and second mortgage loans are designed to provide a secondary market for a variety of loans that may be attractive to potential homeowners.

The composition of the Corporation's loan portfolio at the end of each of the last five years is shown in the table in ''Mortgage Loan Portfolio Composition.'' The composition of its purchases during the last three years is shown in ''Management's Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Mortgage Portfolio.'' Of the single-family and multifamily mortgage loans that the Corporation purchased in 1996, including mortgage-backed securities, approximately 66 percent (measured by unpaid principal balance (''UPB'')) were from investment banking companies, 12 percent were from mortgage banking companies, 7 percent were from savings and loan associations, 7 percent were from commercial and mutual savings banks and

8 percent were from other institutions. All of the Corporation's mortgage loan purchases from investment banking companies were through purchases of mortgage-backed securities.

Principal Balance Limits. Maximum principal balance limits apply to the Corporation's mortgage loan purchases. For 1996, the Corporation could not purchase conventional mortgage loans on one-family dwellings if the loan's original principal balance exceeded $207,000, 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 such conventional mortgage loans secured by one- to four-family dwellings can be adjusted by the Corporation annually based on the national average price of a one-family dwelling as surveyed by the Federal Housing Finance Board. In January 1997, the Corporation increased its maximum principal balance limit to $214,600.

Under the Charter Act, maximum principal balance limits also apply to the Corporation's purchases of conventional multifamily mortgage loans. Such limits are affected by the location of the property and other factors.

Mortgage loans insured by the FHA or guaranteed by the Rural Housing Service are subject to statutory maximum amount limitations. The Corporation will not purchase VA-guaranteed mortgage loans that have principal amounts in excess of amounts that the Corporation specifies from time to time.

Fixed-Rate/Adjustable-Rate. Substantially all fixed-rate mortgage loans purchased by the Corporation provide for level monthly installments of principal and interest. Some of these loans (3 percent of the single-family portfolio at December 31, 1996) have balloon payments due 5, 7 or 10 years after origination, but with monthly payments based on longer (in many cases 30-year) amortization schedules. Many 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.

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. Substantially all ARMs provide for adjustments (up or down) in the amount of monthly installments after the interest rate on the loan is adjusted because of changes in the applicable index. The Corporation currently purchases 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 by the Corporation provide the mortgagor with the option, at specified times or during specified periods of time, to convert the ARM to a fixed-rate mortgage loan with payment of a small fee.

The Corporation also purchases single-family conventional mortgage loans that have one interest rate for the first 5 or 7 years and then adjust automatically to another interest rate for the next 25 or 23 years, respectively. Such loans, in the aggregate, represented less than one percent of its portfolio loan purchases in 1996.

Maturity. The Corporation currently purchases conventional, single-family fixed- and adjustable-rate mortgage loans with original maturities of up to 30 years and 40 years, respectively. Only a small portion of such ARMs purchased have maturities of more than 30 years. The multifamily mortgage loans that the Corporation currently purchases for its portfolio generally are conventional fixed-rate loans that have maturities of up to 30 years.

Repayments

The majority of the single-family mortgage loans in the Corporation's portfolio are prepayable by the borrower (in some cases with a small penalty). Therefore, the Corporation bears the risk that prepayments may increase when interest rates decline significantly or as a result of other factors. The Corporation 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 the Corporation's portfolio provide for a prepayment premium that is calculated under a formula that is intended to protect the Corporation from loss of yield on its investment in the mortgage loan being prepaid.

Portfolio Composition

The following table shows the composition of the Corporation'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 the Corporation's mortgage loan portfolio.

Mortgage Loan Portfolio Composition

(Dollars in millions)

	December 31,				
	1996	**1995**	**1994**	**1993**	**1992**
Single-family:					
Government insured or guaranteed	$ 15,912	$ 13,102	$ 11,659	$ 8,525	$ 9,025
Conventional:					
Long-term, fixed-rate	177,070	140,466	109,079	82,170	66,949
Intermediate-term, fixed-rate	66,284	68,752	68,166	64,623	43,943
Adjustable-rate	12,783	15,108	16,718	19,439	23,278
Second	323	423	536	772	1,356
Multifamily	14,680	15,660	15,899	15,332	13,568
Total UPB	$287,052	$253,511	$222,057	$190,861	$158,119
Yield	7.69%	7.80%	7.80%	7.79%	8.68%

Commitments

The Corporation issues commitments to purchase, during the term of the commitment, a specified dollar amount of mortgage loans. The Corporation purchases mortgage loans through standard product commitments with posted yields and through negotiated commitments.

The Corporation purchases most of its mortgage loans pursuant to mandatory delivery commitments. Under such commitments, lenders are obligated to sell loans to the Corporation 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 for a fee.

The Corporation 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.

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

Underwriting Guidelines

The Corporation has established certain underwriting guidelines for purchases of conventional mortgage loans in an effort to reduce the risk of loss from mortgagor defaults. These guidelines are

designed to assess the creditworthiness of the mortgagor as well as the value of the mortgaged property relative to the amount of the mortgage loan. The Corporation, in its discretion, accepts deviations from the guidelines. The Corporation also reviews and changes its guidelines from time to time. As part of its affordable housing initiatives, the Corporation 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, the Corporation is continuing its community-based experiments involving alternative methods of assessing the creditworthiness of potential borrowers, among other factors. See "Affordable Housing Initiatives and Goals."

The Corporation generally relies on lender representations to ensure that the mortgage loans it purchases conform to its underwriting guidelines. To assist lenders in meeting the underwriting standards, the Corporation enhanced Desktop Underwriter®, its automated underwriting system, in 1996. 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 and objectively to all prospective borrowers. The Corporation also performs post-purchase 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, the Corporation can demand that the lender repurchase the loan.

The Corporation generally has required that the UPB of each conventional single-family first mortgage loan it purchases not be greater than 80 percent of the value of the mortgaged property unless the excess over a specified level is insured by a mortgage insurance company acceptable to the Corporation. The resulting rule for calculating required insurance coverage levels has been replaced by a system that classifies loans into groups by their loan-to-value ("LTV") ratio and specifies a coverage percentage for each such group. The change, which does not affect loans closed before March 1995, was phased in during 1995 for loans originated after February 1995. It increased the coverage percentages for all loans except for fully amortizing fixed-rate loans with terms of 20 years or less and with LTV ratios of 90 percent or less, for which coverage percentages decreased. If mortgage insurance is required initially, it must be maintained as long as the UPB is greater than 80 percent of the original value (or of the appraised value as determined by a subsequent appraisal). The Corporation does not require mortgage insurance on conventional single-family loans with LTV ratios greater than 80 percent if the mortgage loan seller provides other acceptable credit enhancement. The Corporation bears the risk that in some cases parties assuming credit enhancement obligations may be unable to meet their contractual obligations to the Corporation. 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.

The Corporation has required credit enhancement for a majority of the mortgage loans in its multifamily loan portfolio. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Risk Management—Credit Risk Management—Multifamily."

Servicing

The Corporation does not service mortgage loans held in the portfolio, except for government-insured multifamily loans, for which the primary servicing functions are performed by a major servicing entity under a subservicing arrangement. However, the Corporation generally manages and markets properties acquired through foreclosure. Fannie Mae mortgage loans can be serviced only by a servicer approved by the Corporation. Lenders who sell single-family mortgage loans and conventional multifamily loans to the Corporation often service mortgage loans subject to the Corporation's guidelines. Servicing includes the collection and remittance of principal and interest payments, administration of escrow accounts, collection of insurance claims and, if necessary, processing of foreclosures. In the case of multifamily loans, servicing also includes performing property inspections, evaluating the financial condition of owners and transfers of ownership interests, administration of various types of agreements (including agreements regarding replacement reserves, completion/repair and operations and maintenance), responding to requests for partial

releases of security, granting of easements and handling proceeds from casualty losses. The Corporation compensates servicers by permitting them to retain a specified portion of each interest payment on a serviced mortgage loan. The Corporation reserves the right to remove servicing responsibility from a lender.

Mortgage-Backed Securities

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

MBS are backed by loans from one of three sources: a single lender, multiple lenders or the Corporation'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 the Corporation, except when acquired for investment purposes, nor are MBS recorded as liabilities. The Corporation, however, is liable under its guarantee to make timely payments to investors of principal and interest on the mortgage loans in the pools, even if the Corporation has not received payments of principal or interest on the mortgage loans in the underlying pools. MBS enable the Corporation to further its statutory purpose of increasing the liquidity of residential mortgage loans and create a source of guaranty fee income to the Corporation without assuming any debt refinancing risk on the underlying pooled mortgages. Because of the Corporation's guarantees, it assumes the ultimate credit risk of borrowers' defaults on all mortgage loans underlying MBS, as it does for portfolio mortgage loans. See ''Management's Discussion and Analysis of Financial Condition and Results of Operations—Risk Management—Credit Risk Management.''

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

The Corporation issues and guarantees several forms of MBS, including Fannie Majors, that involve only a single class of certificates 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 a 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 the Corporation out of the Corporation's mortgage loan portfolio. Megas represent undivided interests in a pool of MBS, REMIC tranches or pass-through certificates guaranteed by the Government National Mortgage Association (''Ginnie Mae certificates'') of the same type. In addition, the Corporation 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.

The Corporation also issues and guarantees MBS 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 that are each entitled to different cash flows and may represent (a) an undivided interest solely in the principal payments, (b) an undivided interest solely in the interest payments or (c) 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, Ginnie Mae certificates and/or certificates from other REMICs. Pursuant to its guarantee of REMICs and SMBS, the Corporation 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.

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

In many instances, the lender or lenders that originated the loans in an MBS pool created from the Corporation's portfolio or the lender or lenders that exchanged the loans for the MBS (in the case of a "swap" transaction) initially service the loans. The Corporation, 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, the Corporation finds a replacement lender that will service the loans. Generally, the Corporation 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 and Goals

In 1994, the Chairman of the Corporation announced that for the seven years from 1994 through the year 2000 the Corporation would commit $1 trillion to help finance over 10 million homes for families and communities most in need (the "Trillion Dollar Commitment"). As part of the Trillion Dollar Commitment announcement, the Chairman laid out 11 initiatives targeting specific areas of the mortgage finance system for improvement. (In early 1996, the Fannie Mae Foundation undertook three of the initiatives.) By the end of 1996, the Corporation was able to report the following progress with respect to each of the eleven initiatives (including progress on the three Foundation initiatives that were supported by the Corporation): (i) established 25 Partnership Offices around the country and planned to open three additional offices in 1997 (initiative: Fannie Mae Partnership Offices); (ii) established a "Clean Slate" policy, freeing lenders from concerns that they would have to buy back certain community lending affordable housing loans sold to the Corporation in recent years (initiative: Underwriting Flexibilities); (iii) issued $4.5 billion of total commitments to specific underwriting experiments intended to lower barriers to homeownership (initiative: Underwriting Experiments); (iv) targeted emerging markets and those most in need with products designed for seniors, disabled people and their families and Native Americans (initiative: Innovations for Change); (v) originated $8 billion in multifamily financing (initiative: Multifamily Housing Finance); (vi) identified potential savings of approximately $800 related to the origination costs of mortgages through the use of Fannie Mae technology (initiative: Technology to Reduce Costs); (vii) approved more than $27 million of investments in community development financial institutions and increased the percentage of lending to minority borrowers to over 17 percent of the Corporation's total loan volume (initiative: Fighting Discrimination); (viii) together with 29 for-profit, nonprofit and governmental organizations, created the American Homeowner Education and Counseling Institute, an independent nonprofit organization

committed to increased professionalism in homeowner counseling and to identifying more effective ways to finance home buyer education (initiative: HomePath Initiative); (ix) exceeded its original commitment to increase giving to the Fannie Mae Foundation (initiative: Increased Foundation Giving); (x) handled in excess of 1.4 million consumers' requests for homeownership information (initiative: Opening Doors for Every American campaign); and (xi) provided 680,000 immigrants with home-buying information, using multilingual media and community organizations supportive of immigrants (initiative: New Americans Campaign).

Under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the "1992 Act"), the Corporation has certain goals to promote affordable housing for low- and very low-income families and to serve the housing needs of those in underserved areas. In 1996, the Corporation exceeded the applicable goals. 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 by foreclosure, the Corporation 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 the options of a preforeclosure sale or modification) and a variety of other factors. The Corporation 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

The Corporation offers certain services to lenders and other customers in return for a fee. These include issuing REMICs, SMBS, Fannie Megas®, and grantor trust securities, technology services for originating and underwriting loans, and the facilitation of securities transactions.

The Corporation receives fee income from dealers in exchange for creating and issuing REMICs, SMBS, grantor trust securities and Megas. In addition to issuing these securities, the Corporation is responsible for all tax reporting and administration costs associated with these securities.

The Corporation 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 the Corporation on a real-time basis.

The Corporation 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, the Corporation receives fee income through other activities, such as repurchase transactions, and by providing other investment alternatives for customers.

Competition

The Corporation 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, the Corporation competes primarily with the Federal Home Loan Mortgage Corporation ("Freddie Mac"), another government-sponsored enterprise regulated by the Department of Housing and Urban Development ("HUD") and the Office of Federal Housing Enterprise Oversight 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 companies that purchase for their own portfolio or pool single-family mortgage loans for sale to investors as whole loans or mortgage-backed securities. In the case of multifamily products, the Corporation generally competes with government housing programs and with the same kinds of entities as in the case of single-family products, but Freddie Mac is just one among many competitors that vigorously compete in this market.

The Corporation'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 the Corporation.

The Corporation competes primarily on the basis of price, products, 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 the Corporation and Freddie Mac and other market participants.

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 housing goals 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.

Since 1993, Freddie Mac has been adding to its mortgage portfolio significantly, which has increased the competition between the Corporation and Freddie Mac for mortgage loans. In addition, beginning in 1993, Freddie Mac, other traditional lenders, and new lenders began to acquire, or recommenced acquiring, multifamily mortgage loans. In 1994, the Government National Mortgage Association (''Ginnie Mae'') became a competitor in the market for REMICs backed by Ginnie Mae certificates. In addition, both Fannie Mae and Ginnie Mae issued pooled mortgage-backed securities (Megas and Platinums, respectively) backed by Ginnie Mae certificates. However, because the Ginnie Mae guaranty is directly backed by the full faith and credit of the United States, dealers are more likely to exchange their Ginnie Mae certificates for Ginnie Mae Platinums than for Fannie Mae Megas, except in limited situations. Fannie Mae continues to issue REMICs backed by Ginnie Mae certificates, although this activity is expected to dissipate as the Ginnie Mae REMIC continues to evolve.

Under the 1992 Act, the Secretary of HUD must approve any new Fannie Mae or Freddie Mac 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.''

Facilities

The Corporation owns its principal office, which is located at 3900 Wisconsin Avenue, NW, Washington, DC, an office at 3939 Wisconsin Avenue, NW, Washington, DC, and two facilities in Herndon, Virginia. In addition, the Corporation leases approximately 390,000 square feet of office space at 4000 Wisconsin Avenue, NW, which is adjacent to the Corporation's principal office, and approximately 88,000 square feet of office space at 2115 Wisconsin Avenue, NW. The present lease for 4000 Wisconsin Avenue expires in 2003, but the Corporation has options to extend the lease for up to 15 additional years, in 5-year increments. The lease for 2115 Wisconsin expires in 1998 with options to extend the lease for four additional years, in 2-year increments. The Corporation 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 the Corporation'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, the Corporation has opened 25 ''Fannie Mae Partnership Offices'' in leased premises around the country, and plans to establish three additional offices in 1997, which will work with cities, rural areas and other under-served communities. There currently are Fannie Mae Partnership Offices in Phoenix, Arizona; Los Angeles, California; Hartford, Connecticut; Washington, D.C.; Miami, Florida; Orlando, Florida; Atlanta, Georgia; Chicago, Illinois; Des Moines, Iowa; Kansas City, Kansas; New Orleans, Louisiana; Baltimore, Maryland; Boston, Massachusetts; Detroit, Michigan; St. Paul, Minnesota; St. Louis,

Missouri; Las Vegas, Nevada; New York, New York; Charlotte, North Carolina; Cleveland, Ohio; Portland, Oregon; Houston, Texas; San Antonio, Texas (two offices, one of which is responsible for border region issues); and Seattle, Washington.

Employees

At December 31, 1996, the Corporation employed approximately 3,300 full-time personnel.

GOVERNMENT REGULATION AND CHARTER ACT

The Corporation 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 Corporation 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, the Corporation was constituted as a federally chartered corporation and the entire equity interest in the Corporation became stockholder-owned.

Although the 1968 Act eliminated all federal ownership interest in the Corporation, it did not terminate government regulation of the Corporation. Under the Charter Act, approval of the Secretary of the Treasury is required for the Corporation's issuance of its debt obligations and MBS. In addition, the 1992 Act established an independent Office of Federal Housing Enterprise Oversight ("OFHEO") within HUD under the management of a Director (the "Director") who is responsible for ensuring that the Corporation is adequately capitalized and operating safely in accordance with the 1992 Act. The 1992 Act established minimum capital, risk-based capital and critical capital levels for the Corporation and required the Director to establish, by regulation, a risk-based capital test to be used to determine the amount of total capital the Corporation must have to exceed the risk-based capital level from time to time. 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, which finalized an original proposal dated June 1995, formalized the interim capital standards applied by OFHEO, with which the Corporation 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 Capital Requirements."

In 1996, OFHEO also released for comment part one ("Part I") of the proposed regulations to establish the risk-based capital test. Part I specifies that "benchmark loss experience" will be combined with other yet to be determined assumptions and applied each quarter to the Corporation's

book of business to establish credit losses under the risk-based capital standard for the Corporation. Part I also specifies the house price index that OFHEO will use in connection with the risk-based capital standard. The Corporation submitted comments to OFHEO in October 1996 stating that several aspects of the initial proposal require adjustments or amendment, because it does not accurately capture the Corporation'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. OFHEO has indicated that it plans to release a proposed second part of the risk-based capital regulation, which will specify, among other matters, remaining aspects of the stress test and how the stress test will be used to determine Fannie Mae's and Freddie Mac's risk-based capital requirements. Management understands that OFHEO expects to publish this second part in 1997. Management is optimistic that the final regulations will permit the Corporation to manage its business in a reasonably efficient manner.

If the Corporation 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 the Corporation fails to meet. The Director's enforcement powers include the power to impose temporary and final cease-and-desist orders and civil penalties on the Corporation and on directors or executive officers of the Corporation. If the Director determines that the Corporation 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 the Corporation has decreased significantly, the Director is authorized to treat the Corporation as not meeting one of the capital standards that it otherwise meets. In addition, the Corporation 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 the Corporation has failed to make reasonable efforts to comply with the plan, then the Director may treat the Corporation as not meeting one of the capital standards that it otherwise meets. Also, if the Corporation 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 the Corporation or any executive officer or director of the Corporation is engaging in or about to engage in any conduct that threatens to result in a significant depletion of the Corporation'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 the Corporation to pay a dividend if the dividend would decrease the Corporation's capital below risk-based capital or minimum capital levels established under the 1992 Act. See "Common Stock." 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 also gives the Director the authority to conduct on-site examinations of the Corporation for purposes of ensuring the Corporation's financial safety and soundness. In addition, the Corporation is required to submit annual and quarterly reports of the financial condition and operations of the Corporation to the Director. Moreover, the Charter Act, as amended by the 1992 Act, authorizes the General Accounting Office to audit the programs, activities, receipts, expenditures and financial transactions of the Corporation. The Corporation also is required to submit an annual report to the House and Senate Banking Committees and the Secretary of HUD regarding the Corporation'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.

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 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 the Corporation 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 the Corporation. The Secretary has adopted regulations related to the program approval requirement.

Thirteen members of the Corporation's eighteen-member Board of Directors are elected by the holders of the Corporation'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 the Corporation under federal regulation, the Charter Act also grants to the Corporation certain privileges. For instance, securities issued by the Corporation 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 the Corporation's securities are not filed with the SEC. The Corporation 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 the Corporation up to a maximum of $2.25 billion outstanding at any one time. This facility has not been used since the Corporation's transition from government ownership in 1968. Neither the United States nor any agency thereof is obligated to finance the Corporation's operations or to assist the Corporation in any other manner.

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

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

The 1992 Act required the Comptroller General of the United States ("GAO"), the Secretary of HUD, the Secretary of Treasury and the Director of Congressional Budget Office ("CBO") to conduct and submit studies of issues associated with the further privatization of the Corporation and Freddie Mac to the House and Senate Banking Committees. Although the statutory deadline for the studies was October 1994, the reports were issued in the summer of 1996. While the GAO and the CBO reports also considered the impact of alternatives other than full privatization, neither report made a recommendation regarding full privatization or the other alternatives. The Treasury report stated that it is premature to consider full privatization of the Corporation, and the HUD report recommended against full privatization of the Corporation at the time the report was issued. The HUD report also recommended that the issue of full privatization be reexamined periodically. The House Banking Subcommittee on Capital Markets, Securities and Government-Sponsored Enterprises held hearings on the reports in the summer of 1996. Management cannot predict the impact, if any, of such studies on the Corporation. Full privatization would require legislation by Congress.

In December 1996, HUD issued substantially revised HUD Book-Entry Regulations, effective January 1, 1997 (Federal Register, vol. 61, p. 63,944 (Dec. 2, 1996). Such regulations apply to the

Corporation's securities (including debentures, global debt securities, medium-term notes and MBS) that are issued or maintained on the Fed Book-Entry System on or after January 1, 1997.

LEGAL PROCEEDINGS

In the ordinary course of business, the Corporation is involved in legal proceedings that arise in connection with properties acquired by the Corporation, either through foreclosure on properties securing delinquent mortgage loans owned by the Corporation 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.

The Corporation 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 the Corporation, or disputes concerning termination by the Corporation (for any of a variety of reasons) of a lender's authority to do business with the Corporation as a seller and/or servicer, can result in litigation. Also, loan servicing issues have resulted from time to time in claims against the Corporation brought as putative class actions for borrowers.

The Corporation 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 the Corporation, management believes that their outcome will not have a material adverse effect on the Corporation's financial condition or results of operations.

COMMON STOCK

Section 303(a) of the Charter Act provides that the Corporation 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 stockholder vote. The holders of the common stock elect thirteen directors, and the President of the United States appoints the remaining five directors. 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. The Charter Act, the Corporation's governing instrument, cannot be amended by the stockholders, but only by an Act of Congress.

The Corporation also is authorized by the Charter Act to have preferred stock on such terms and conditions as the Board of Directors of the Corporation may prescribe. No common stockholder approval is required to issue preferred stock. The Corporation issued $1 billion of non-cumulative preferred stock in 1996 that is redeemable beginning in 2001. See "Notes to Financial Statements — Note 10" for additional information on preferred stock.

The Charter Act contains no limitation on the amount of stock that may be issued, except that if the Corporation fails to meet certain minimum capital standards, the Director could require that the Director approve the Corporation's issuance of stock or securities convertible into stock. At February 28, 1997, there were outstanding approximately 1,064 million shares of common stock, which were held by approximately 19,000 stockholders of record. Based on the number of requests for proxies and quarterly reports, the Corporation estimates that on February 28, 1997 there were approximately 235,000 additional stockholders who held shares through banks, brokers and nominees.

Holders of the common 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 levels for the Corporation, and required the

Director of OFHEO to establish, by regulation, a risk-based capital test to be used to determine the amount of total capital the Corporation must have to exceed the risk-based capital level from time to time. The Corporation has submitted comments on Part I of OFHEO's proposed regulation for the risk-based capital test (released in 1996) and management understands that OFHEO expects to publish for comment in 1997 the second part of the proposed regulations. See "Government Regulation and Charter Act." 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 if the Corporation meets the minimum capital level established under the 1992 Act and the dividend payment would not decrease the Corporation's base capital below such level. See "Government Regulation and Charter Act" regarding the final rule applicable to the minimum capital level.

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 the Corporation meets both the risk-based capital and minimum capital levels and the dividend payment would not decrease the Corporation's total capital below the risk-based capital level or its core capital below the minimum capital level. If the Corporation 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 the Corporation to fail to meet another capital standard. At any time when the Corporation does not meet the risk-based capital standard but meets the minimum capital standard, the Corporation is prohibited from making a dividend payment that would cause the Corporation to fail to meet the minimum capital standard. If the Corporation 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 the Corporation 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 the Corporation to submit a report to the Director regarding any capital distribution (including any dividend) declared by the Corporation before the Corporation 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 Capital Requirements" regarding the capital standards applicable to the Corporation.

The payment of dividends on common stock also is subject to the payment of dividends on any preferred stock outstanding.

Dividends on common stock have been declared and paid for each quarter during the Corporation's two most recent fiscal years. See "Quarterly Results of Operations" on page 65 for quarterly dividends paid on common stock during 1996 and 1995.

In the event of liquidation of the Corporation, holders of common stock are entitled to share ratably, in accordance with their holdings, in the remaining assets of the Corporation after payment of all liabilities of the Corporation and amounts payable to the holders of preferred stock.

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 the Corporation of its own common stock, holding such common stock in its treasury, and reselling such stock.

This description is summarized from the Charter Act, the 1992 Act, the bylaws and certain resolutions of the Board of Directors and stockholders of the Corporation. 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 the Corporation and such resolutions. Copies of the Charter Act, the bylaws of the Corporation and any applicable resolutions may be obtained from the Corporation.

The Corporation'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 ChaseMellon Shareholder Services, 85 Challenger Road, Ridgefield Park, NJ 07660.

The following table shows, for the periods indicated, the high and low prices per share of the Corporation's common stock on the New York Stock Exchange Composite Transactions as reported in the Bloomberg Financial Markets service.

Quarterly Common Stock Data

	1996		1995	
Quarter	High	Low	High	Low
1st	$35.75	$28.75	$20.91	$17.19
2nd	34.50	27.50	25.03	20.25
3rd	35.38	29.13	26.50	22.53
4th	41.63	34.50	31.50	25.00

The closing price of the Corporation's common stock on March 27, 1997, as so reported, was $38.375.

FORWARD-LOOKING INFORMATION

From time to time, the Corporation may make forward-looking statements relating to matters such as the Corporation'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" 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 the Corporation is active, as well as the Corporation's business plans. As such forward-looking statements are subject to risks and uncertainties, the Corporation'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 the Corporation'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 the Corporation'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, the Corporation's funding opportunities or the Corporation'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 the Corporation'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 the Corporation, its competitors or the markets in which the Corporation is active, including changes in taxes or capital requirements applicable to the Corporation 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 Capital Requirements" regarding certain matters currently being considered by regulators or legislators);

- 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 the Corporation'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. While the Corporation has achieved 36 consecutive quarters of record operating earnings despite major fluctuations in interest rates during this period and employs a variety of interest rate risk management techniques, it is possible that sudden, severe swings in interest rates could have at least a short-term significant effect on the Corporation's results.

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

SELECTED FINANCIAL INFORMATION: 1992-1996

The following selected financial data for the years 1992 through 1996 (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 and shares in millions, except per share amounts)

	Year Ended December 31,				
Income Statement Data:	**1996**	**1995**	**1994**	**1993**	**1992**
Interest income	$ 23,772	$ 21,071	$ 17,347	$ 14,833	$ 13,534
Interest expense	20,180	18,024	14,524	12,300	11,476
Net interest income	3,592	3,047	2,823	2,533	2,058
Guaranty fees	1,196	1,086	1,083	961	834
Miscellaneous income, net	86	93	143	259	191
Credit-related expenses	(409)	(335)	(378)	(305)	(320)
Administrative expenses	(560)	(546)	(525)	(443)	(381)
Special contribution	—	(350)	—	—	—
Income before federal income taxes and extraordinary item	3,905	2,995	3,146	3,005	2,382
Provision for federal income taxes	(1,151)	(840)	(1,005)	(963)	(733)
Income before extraordinary item	2,754	2,155	2,141	2,042	1,649
Extraordinary loss—early extinguishment of debt, net of tax effect	(29)	(11)	(9)	(169)	(26)
Net income	$ 2,725	$ 2,144	$ 2,132	$ 1,873	$ 1,623
Preferred stock dividends	(42)	—	—	—	—
Net income available to common stockholders	$ 2,683	$ 2,144	$ 2,132	$ 1,873	$ 1,623
Per common share:					
Earnings before extraordinary item	$ 2.50	$ 1.96	$ 1.95	$ 1.86	$ 1.50
Net earnings	2.48	1.95	1.94	1.71	1.48
Cash dividends	.76	.68	.60	.46	.35

	December 31,				
Balance Sheet Data:	**1996**	**1995**	**1994**	**1993**	**1992**
Mortgage portfolio, net	$286,259	$252,588	$220,525	$189,982	$156,021
Investments	56,606	57,273	46,335	21,396	19,574
Total assets	351,041	316,550	272,508	216,979	180,978
Borrowings:					
Due within one year	159,900	146,153	112,602	71,950	56,404
Due after one year	171,370	153,021	144,628	129,162	109,896
Total liabilities	338,268	305,591	262,967	208,927	174,204
Stockholders' equity	12,773	10,959	9,541	8,052	6,774
Capital(1)	13,520	11,703	10,367	8,893	7,554

	Year Ended December 31,				
Other Data:	**1996**	**1995**	**1994**	**1993**	**1992**
Net interest margin	1.18%	1.16%	1.24%	1.38%	1.37%
Return on average common equity	24.1	20.9	24.3	25.3	26.5
Mortgage purchases	$ 68,618	$ 56,598	$ 62,389	$ 92,037	$ 75,905
MBS issued	149,869	110,456	130,622	221,444	194,037
MBS outstanding at year-end(2)	650,780	582,959	530,343	495,525	444,979
Return on average assets	.81%	.75%	.88%	.97%	1.00%
Ratio of earnings to combined fixed charges and preferred stock dividends(3)	1.19:1	1.17:1	1.22:1	1.22:1	1.20:1
Dividend payout ratio	30.4%	34.6%	30.8%	26.9%	23.2%
Credit loss ratio	.053	.050	.057	.040	.040
Average common shares outstanding	1,083	1,102	1,098	1,098	1,098
Book value per common share	$ 11.09	$ 10.04	$ 8.74	$ 7.39	$ 6.20

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

(2) Includes $103 billion, $70 billion, $44 billion, $24 billion and $21 billion of MBS in portfolio at December 31, 1996, 1995, 1994, 1993 and 1992, respectively.

(3) "Earnings" consists of (i) income before federal income taxes and extraordinary item and (ii) fixed charges. "Fixed charges" represents interest expense. There was no preferred stock outstanding in 1995, 1994, 1993 and 1992.

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

This discussion highlights significant factors influencing the financial condition and results of operations of the Corporation. It should be read in conjunction with the financial statements and related notes. This discussion includes certain forward-looking statements based on management's estimates of trends and economic factors in the markets in which the Corporation is active, as well as the Corporation's business plans. In light of recent securities law developments, including the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, the Corporation 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 the Corporation, 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 the Corporation. The "Forward-Looking Information" section of this Information Statement discusses certain factors that may cause such differences to occur.

Overview

Nineteen ninety-six was an outstanding year for both Fannie Mae and its stockholders. Net income increased for the tenth consecutive year to $2.725 billion from $2.144 billion in 1995, and earnings per common share were $2.48, up from $1.95 in 1995. Results for 1995 included the effect of a commitment to contribute $350 million in Fannie Mae common stock to the Fannie Mae Foundation. Without this special contribution, 1995 earnings would have been $2.372 billion, or $2.15 per common share. Growth in the mortgage portfolio, net interest margin, net MBS outstanding and average effective guaranty fee rate were the primary factors in producing the record earnings in 1996. In addition to the increase in earnings during 1996, the Corporation also successfully completed the first phase of the capital restructuring program announced at the end of 1995.

The Corporation's core capital (stockholders' equity) grew 17 percent to $12.8 billion at December 31, 1996. This level exceeded regulatory capital standards at December 31, 1996. Management expects that continued growth in retained earnings will ensure compliance with all applicable capital standards in the future.

The remainder of Management's Discussion and Analysis includes detailed information on the Corporation's results of operations, risk management, balance sheet analysis, mortgage-backed securities activity and housing goals.

Results of Operations

Net Interest Income

Net interest income increased $545 million to $3.592 billion in 1996 as a result of a $36 billion, or 16 percent, increase in the average mortgage portfolio balance and a .02 percentage point increase in the average net interest margin.

The increase in the average net interest margin to 1.18 percent in 1996 was caused, in part, by the Corporation calling and refunding a substantial amount of higher cost debt when interest rates declined in early 1996. For 1997, management believes that net interest income will continue to increase, principally as a result of growth in the average mortgage portfolio, while the net interest margin is not expected to be significantly different from its average in 1996.

Net interest income excludes interest receivable on nonperforming loans. Conventional single-family and multifamily loans are classified as nonperforming and previously accrued interest is removed from income when a payment is 90 days or more past due. Nonperforming loans outstanding totaled $2.1 billion at the end of 1996 and 1995. If these nonperforming assets had been fully performing, they would have contributed an additional $147 million to net interest income in 1996, and $122 million in 1995.

Guaranty Fee Income

Guaranty fee income increased $110 million to $1.196 billion in 1996, compared with $1.086 billion in 1995. The increase in guaranty fee income resulted from a $40 billion increase in average net MBS outstanding and an increase of .004 percentage points in the average effective guaranty fee rate. The increase in the effective guaranty fee rate was largely the result of higher fee rates on new business in 1996. Guaranty fees compensate the Corporation for its guarantee of timely payment of principal and interest to MBS investors and its assumption of credit risk on loans underlying MBS.

The following table presents guaranty fee income as a percentage of the average balance of MBS outstanding, net of MBS held in portfolio, in 1996, 1995 and 1994.

Guaranty Fee Data

	1996	1995	1994
	(Dollars in millions)		
Guaranty fee income	$ 1,196	$ 1,086	$ 1,083
Average balance of net MBS outstanding	534,553	494,689	481,987
Effective guaranty fee rate	.224%	.220%	.225%

Additional information on the Corporation's MBS and guaranty fees is presented under "Mortgage-Backed Securities."

Miscellaneous Income

Miscellaneous income is composed of REMIC and other MBS-related fees, net operating losses from equity investments in affordable housing projects, and other miscellaneous items. The 8 percent decline in miscellaneous income during 1996 was the result of lower REMIC fee income, which was partially offset by an increase in other miscellaneous fees. The Corporation recognized additional deferred REMIC fees in 1995 due to lower than expected REMIC processing costs. Additional information on REMIC activity is presented under "Mortgage-Backed Securities."

Credit-Related Expenses

Credit-related expenses, which include foreclosed property expenses and the provision for losses, were $409 million in 1996, compared with $335 million in 1995. The increase in credit-related expenses reflected continued high levels of property acquisitions in California as well as the Corporation's efforts to shorten the period between delinquency and foreclosure, which had the effect of accelerating future losses into 1996.

Management anticipates that credit-related expenses will remain relatively level in 1997, despite continued growth in the mortgage portfolio and MBS outstanding. In 1997, the Corporation expects to benefit from a lower loss per foreclosed property, deeper mortgage insurance on high LTV loans, and a relatively healthy housing market across the nation.

Administrative Expenses

Administrative expenses grew only 3 percent to $560 million in 1996, compared with $546 million in 1995. Management has controlled administrative expense growth while devoting significant resources to housing initiatives, loss mitigation activities and continued investments in technology. Compensation expense was $344 million in 1996, compared with $312 million in 1995.

The ratio of administrative expenses to the average net mortgage portfolio plus average net MBS outstanding declined to .070 percent in 1996 from .075 percent in 1995. The ratio of administrative expenses to revenues (net interest income, guaranty fees and miscellaneous income) was 11.5 percent in 1996 and 12.9 percent in 1995.

Income Taxes

The provision for federal income taxes, net of the tax benefit from extraordinary losses, was $1.135 billion in 1996, compared with $834 million in 1995. The effective federal income tax rate increased to 29 percent in 1996 from 28 percent in 1995. The increase from the previous year was due to a favorable settlement with the IRS in 1995 of several items related to the 1986 and 1987 tax years.

Extraordinary Loss

The repurchase and call of debt and the call of certain interest rate swaps are part of the Corporation's interest rate risk management strategy.

As a result of repurchase and call activity, the Corporation recognized net extraordinary losses of $45 million ($29 million after tax) in 1996, compared with $17 million ($11 million after tax) in 1995. The repurchase or call of high-coupon debt favorably affects the Corporation's future cost of funds.

During 1996, the amount of long-term debt called or repurchased and the notional principal amount of interest rate swaps called was $26 billion with a weighted-average cost of 7.09 percent. The comparable amount in 1995 was $20 billion with a weighted-average cost of 7.24 percent.

Risk Management

Active management of risk is an integral part of the Corporation's operations and a key determinant of its ability to maintain steady earnings growth. The Corporation employs various strategies to diversify and mitigate the major risks to which it is exposed. The following discussion highlights the Corporation's strategies for managing its two major risks: interest rate risk and credit risk.

Interest Rate Risk Management

Fannie Mae's management of interest rate risk involves analyses and actions that position the Corporation to meet long-term goals and objectives in a wide range of interest rate environments. Central elements of Fannie Mae's approach to managing interest rate risk include investing in assets and issuing liabilities that perform similarly in different interest rate environments, assessing portfolio profitability and risk in the event of changes in interest rates, and rebalancing the portfolio when necessary to enhance its ability to meet the Corporation's long-term objectives.

The Corporation invests in mortgage assets and issues debt to fund those assets based on analyses of projected performance over a wide range of interest rate scenarios. Assets are funded with liabilities that have largely comparable durations, or average cash flow patterns through time. 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 with similar duration characteristics is frequently issued. The duration of callable debt, like that of a mortgage asset, shortens when interest rates decrease and lengthens when interest rates increase. In addition to callable debt, the Corporation utilizes off-balance-sheet financial instruments, primarily interest rate swaps, to achieve its desired liability structure and better match the prepayment risk of the mortgage portfolio.

Because the assets and the liabilities in Fannie Mae's portfolio are not perfectly matched, the portfolio's projected performance changes to some degree with movements in interest rates. To monitor and manage this change, the portfolio's risk is regularly assessed using a diverse set of measures and analyses, including frequent projections of portfolio net interest income over a broad range of interest rate scenarios. Additional information about interest rate risk is obtained by means of financial performance simulations in which highly stressful interest rate scenarios are assumed. Based on these and other analyses, and assessments of conditions in the financial markets, management makes decisions about the necessity or desirability of portfolio rebalancing. A variety of

techniques, such as adjusting liability durations or emphasizing different asset classes, may be used to accomplish these rebalancings.

The duration gap, the difference between the duration of portfolio assets and liabilities, summarizes for management the extent to which asset and liability cash flows are matched on average through time. At December 31, 1996, the duration gap of Fannie Mae's mortgage portfolio was a positive four months, in comparison with a negative duration gap of three months at the end of 1995. A positive duration gap results when the duration of mortgage assets is longer than the duration of the related liabilities, and indicates that the Corporation has more interest rate exposure in a rising rate environment. A goal of the Corporation is to maintain the duration gap close to zero through management of the durations of its assets and liabilities. Although interest rates increased during the year and the duration of portfolio assets lengthened relative to liabilities, the increase in the duration gap was modest, as Fannie Mae undertook rebalancing measures to extend the average duration of its liabilities.

Additional information on interest rate risk management is presented under "Balance Sheet Analysis—Financing Activities."

Credit Risk Management

The Corporation's primary exposure to credit risk results from the possibility that it will not recover amounts due from borrowers. Management attempts to reduce this risk through disciplined underwriting guidelines and loan servicing requirements and, in the event of default, effective loss mitigation efforts.

The Corporation also is subject to the credit risk that counterparties to its transactions may be unable to meet their contractual obligations to Fannie Mae. Additional information on this credit risk exposure is presented under "Balance Sheet Analysis—Financing Activities" and in the Notes to Financial Statements, "Financial Instruments with Off-Balance-Sheet Risk" and "Concentrations of Credit Risk." The discussion that follows addresses the major elements of credit risk management as they pertain to conventional single-family and multifamily mortgages.

Single-Family

The Corporation manages its single-family mortgage credit risk by focusing on two phases which, if not managed effectively, increase the likelihood of credit loss: loan underwriting and loan servicing.

In the first phase, loan underwriting, the Corporation manages credit risk through its efforts to ensure that the analyses performed by lenders on loans sold to Fannie Mae meet the Corporation's underwriting criteria.

In 1996, Fannie Mae expanded the tools it offers lenders to assist them in meeting the Corporation's underwriting standards by enhancing Desktop Underwriter®, the Corporation's automated underwriting system. The specific enhancements made in 1996 include the addition of a credit scoring model to the system's comprehensive borrower risk analysis, as well as a property appraisal risk assessment model.

Desktop Underwriter® is a decision support tool, designed to help lenders process mortgage applications in a more efficient and accurate manner. It provides benefits to lenders, borrowers and the Corporation by consistently and objectively applying the Corporation's underwriting criteria to all prospective borrowers. Management expects to continue investing in research and technology, such as Desktop Underwriter, to provide lenders and the Corporation with additional quantitative information for evaluating and managing credit risk while expanding homeownership opportunities.

In addition to the use of technology in managing credit risk, Fannie Mae also has adjusted underwriting requirements in an effort to reduce credit losses. For example, in 1995 the Corporation

increased the level of private mortgage insurance to mitigate credit risk associated with low down payment loans.

In the second phase of credit risk management, loan servicing, the Corporation manages the risk of credit loss by requiring its servicers to follow guidelines for servicing a loan owned or guaranteed by Fannie Mae. These guidelines help ensure that all loans are serviced consistently and efficiently. The Corporation also uses technology to get better and more timely information from its servicers regarding the stages and characteristics of nonperforming loans. This data enables the Corporation to evaluate the effectiveness of loss mitigation activities and to determine other actions the Corporation could take to further reduce losses.

An important element in loan servicing is the servicer's responsibility to carry out loss mitigation activities. A major component of loss mitigation is early intervention in a delinquency. Experience has shown that once a borrower has missed three or more payments, it is less likely the loan will become current. To help keep borrowers in their homes or reduce the costs incurred when a loan goes through the foreclosure process, borrowers are contacted early in a delinquency to determine whether their loan might be worked out through a repayment plan, temporary forbearance, or modification of terms. One of the Corporation's more successful programs has been individually tailored repayment plans, where borrowers agree to make additional payments to pay down past due amounts while still making their regularly scheduled payments. A modification may allow the borrower to pay the past due amount over the remaining life of the mortgage, extend the term of the loan, or lower the interest rate for a short time in lieu of the loan servicer foreclosing on the property. If repayment plans, forbearance, or modification are not appropriate, the loan servicer may attempt to arrange a preforeclosure sale. The benefits of a preforeclosure sale include avoidance of the costs of foreclosure and a tendency for the property to sell at a better price because the home generally is occupied. If a preforeclosure sale is not possible, the Corporation's goal is to expeditiously handle the foreclosure process to minimize the amount of time the Corporation retains a nonearning asset.

As shown in the following table, the Corporation experienced a 49 percent increase in foreclosed property acquisitions in 1996 versus 1995. This increase in foreclosures was primarily the result of a weak, although improving, housing market in California, together with the Corporation's efforts to shorten the period between delinquency and foreclosure. Credit-related losses, however, rose by only 18 percent, or $62 million, in 1996 compared with 1995. The smaller increase in credit losses in 1996 stemmed from a reduction in the average loss per foreclosed property to $17,000 from $21,000 in 1995.

Single-Family Foreclosed Property Data

	Year Ended December 31,		
	1996	1995	1994
	(Dollars in millions)		
Acquired properties:			
Northeast	3,893	3,296	3,490
Southeast	2,667	1,767	1,739
Midwest	987	660	670
Southwest	1,780	1,326	1,579
West	11,399	6,892	5,738
Total	20,726	13,941	13,216
Charge-offs:			
Acquired properties	$ 132	$ 95	$ 104
Preforeclosure sales	59	51	41
	191	146	145
Foreclosed property expenses	216	199	228
Credit-related losses	$ 407	$ 345	$ 373
Credit loss ratio	.053%	.049%	.056%
Number of preforeclosure sales	4,130	4,030	3,417

The Corporation continued to experience a disproportionate share of credit-related losses from its California book of business. While at December 31, 1996 only 21 percent of Fannie Mae's total book of business was located in California, over 50 percent of acquired properties in 1996 were from California. Moreover, 67 percent of total credit-related losses came from California loans in 1996, compared with 57 percent in 1995. Because of the improving housing market in California, the Corporation believes that 1996 will be the peak year for losses in that state.

Fannie Mae's credit loss ratio—credit-related losses as a percentage of the average UPB of total mortgages in portfolio and underlying MBS outstanding—has remained in a relatively narrow range between .04 percent and .06 percent over the past five years, and was .053 percent in 1996. Management expects the 1997 credit loss ratio to decline from the 1996 level.

The total number of single-family properties owned by Fannie Mae at December 31, 1996 was 9,600, compared with 6,600 and 6,200 at December 31, 1995 and 1994, respectively. These properties had net carrying amounts of $820 million, $545 million and $485 million at December 31, 1996, 1995 and 1994, respectively.

In evaluating expected future credit performance, management analyzes the risk profile of the conventional single-family loans in the Corporation's portfolio and underlying MBS. The LTV ratio is an important factor in credit performance because the amount of equity a borrower has in a home has proven to be a key determinant of the incidence and severity of default.

Product mix also influences potential future credit losses because the credit risks associated with each product type vary. Adjustable-rate mortgages tend to have a higher incidence of default than long-term fixed-rate mortgages, while intermediate-term fixed-rate mortgages tend to have a lower incidence of default.

The following table presents data, by percentage of UPB, on Fannie Mae conventional loans purchased for the Corporation's own portfolio or underlying its MBS issuances in the years 1996, 1995 and 1994 by product distribution, LTV ratio at time of origination and current LTV ratio. In addition, this table presents data on these same measures for conventional loans outstanding in the Corporation's portfolio or underlying its MBS at December 31, 1996 and 1995. Current LTV ratios are derived by adjusting the value of a property by the estimated change in the price of the home since

the mortgage was originated, and comparing this adjusted value to the current unpaid principal balance of the mortgage.

Distribution of Single-Family Loans by Product Type and Loan-to-Value Ratios

	Outstanding at December 31,		Percentage of Business Volumes		
	1996	1995	1996	1995	1994
Product:					
Long-term, fixed-rate	62%	60%	70%	70%	65%
Intermediate-term, fixed-rate(1)	28	29	22	19	26
Adjustable-rate	10	11	8	11	9
Total	100%	100%	100%	100%	100%
Original loan-to-value ratio:					
Greater than 90%	12%	11%	16%	19%	14%
81% to 90%	17	17	18	18	18
71% to 80%	38	37	38	36	36
61% to 70%	14	15	13	12	14
Less than 61%	19	20	15	15	18
Total	100%	100%	100%	100%	100%
Average original loan-to-value ratio	74%	73%	76%	77%	75%
Current loan-to-value ratio:					
Greater than 90%	5%	5%			
81% to 90%	14	14			
71% to 80%	24	24			
61% to 70%	20	21			
Less than 61%	37	36			
Total	100%	100%			
Average current loan-to-value ratio	64%	65%			
Average loan amount (Maximum $207,000 in 1996)	$83,200	$81,800	$99,900	$97,400	$95,100

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

The table below summarizes conventional single-family serious delinquencies by region as of December 31, 1996, 1995, and 1994. Single-family serious delinquency rates are based on the number of conventional loans in portfolio and underlying MBS for which the Corporation has primary risk of loss and that are delinquent 90 days or more or in the process of foreclosure.

Single-Family Serious Delinquency Rates

	December 31,		
	1996	**1995**	**1994**
Northeast	.87%	.83%	.75%
Southeast	.51	.45	.33
Midwest	.33	.28	.21
Southwest	.40	.36	.28
West	.74	.82	.69
Total	.58%	.56%	.47%

In 1996 the total delinquency rate increased .02 percentage points, reflecting a small increase in all regions except the Western region. The decline in the Western region delinquency rate resulted from recent improvements in the California economy and housing market.

Experience has shown that loan age is a major factor affecting delinquency rates, and that the incidence of default for a group of mortgage loans peaks in the third through fifth years after origination. Unless real estate values decline significantly, loans outstanding after five years tend to have lower default rates because borrowers have a history of being able to make their payments and most likely have built up additional equity in their properties. The Corporation acquired a significant portion of its portfolio and MBS outstanding between 1991 and 1993 (48 percent of total outstanding UPB at December 31, 1996), and these loans are now at the stage where they are most likely to be delinquent or in foreclosure.

Multifamily

There are two primary risks involved in the underwriting and management of income-producing multifamily properties: that underlying property cash flows will be insufficient to service the debt over the life of the loan, and that proceeds from the sale or refinancing of a property will be insufficient to repay the loan at maturity.

Fannie Mae manages the credit risk on its multifamily loan portfolio in several ways. First, the Corporation maintains rigorous loan underwriting guidelines, coupled with extensive real estate due diligence examinations for loan acquisitions. Because multifamily loans are primarily cash flow dependent and much larger than single-family loans, management actively monitors the ongoing performance of individual loans by requiring servicers to submit annual operating information and property condition reviews. This information, combined with other loan risk characteristics, is used to evaluate periodically the credit quality of the portfolio to identify potential problem loans and initiate appropriate loss mitigation activities.

A second way the Corporation manages its credit risk exposure is through various forms of credit enhancement. For the majority of multifamily loans, the Corporation has either shared risk arrangements with lenders, full or partial recourse for loan losses to lenders or third parties (which may be secured by letters of credit or pledged collateral), or government mortgage insurance.

The shared risk category is composed of loans purchased under the Delegated Underwriting and Servicing ("DUS") product line. Under the DUS product, lenders generally bear losses up to 5 percent of the unpaid principal balance at the time of loss, with any remaining losses shared by the

lender and Fannie Mae. The risk profile of multifamily loans in portfolio and underlying MBS at December 31, 1996, 1995 and 1994 are set forth in the table below.

Multifamily Risk Profile

	1996	1995	1994
Fannie Mae risk	15%	17%	16%
Shared risk	44	39	39
Recourse (1)	41	44	45
Total	100%	100%	100%

(1) Includes loans backed by collateral, with government mortgage insurance, or with full or partial lender recourse to lenders or third parties.

The Corporation's Western region represented 35 percent of the conventional loans in the multifamily portfolio and underlying MBS outstanding at December 31, 1996, of which 82 percent involved shared risk or recourse. At December 31, 1995, the Western region comprised 39 percent of the outstanding book of business, 81 percent of which involved shared risk or recourse.

Multifamily serious delinquencies at December 31, 1996, 1995, and 1994 were .68 percent, .81 percent and 1.21 percent, respectively. Multifamily serious delinquencies are those loans for which the Corporation has primary risk of loss (including those with shared risk) that are two months or more delinquent. Multifamily delinquency percentages are based on the unpaid principal amount of such loans in portfolio and underlying MBS.

Due to strong underwriting, stabilization in the multifamily rental market, declining interest rates, and continued emphasis on early loss mitigation efforts, the level of serious delinquencies for multifamily loans has declined significantly over the last several years.

Multifamily foreclosed property acquisitions totaled 54 properties, 75 properties, and 31 properties during 1996, 1995, and 1994, respectively. During 1996 and 1995, properties acquired included 34 and 62 properties, respectively, from a portfolio that transferred from recourse to Fannie Mae risk in 1995. As part of the 1995 transaction, the Corporation has been receiving supplemental fees to help offset expected losses. At December 31, 1996 and 1995, the Corporation held 27 foreclosed properties with an aggregate carrying value of $34 million and 28 foreclosed properties with an aggregate carrying value of $40 million, respectively, where Fannie Mae has the primary risk of loss.

Credit-related losses and the ratio of credit losses to average principal balances outstanding for multifamily loans in portfolio and underlying MBS are summarized in the following table.

Multifamily Credit-Related Losses

	Year Ended December 31,		
	1996	1995	1994
	(Dollars in millions)		
Charge-offs	$ 19	$ 26	$ 24
Foreclosed property income	(3)	(4)	(5)
Credit-related losses	$ 16	$ 22	$ 19
Credit loss ratio	.054%	.085%	.078%

In 1996, multifamily credit-related losses decreased as a result of lower charge-offs, which more than offset the slight decrease in foreclosed property income. Credit-related losses have remained

relatively stable, despite increased business, due primarily to active management of delinquent multifamily assets and a healthy multifamily rental market. The Corporation expects multifamily credit-related losses to increase somewhat in 1997 due to growth in outstanding multifamily book of business.

Allowance for Losses

In evaluating the risk of loss on portfolio loans and MBS outstanding, management considers current delinquency levels, historical loss experience, current economic conditions, geographic concentrations, estimates of future loan losses, and other pertinent factors. The allowance for losses is established by recording an expense for the provision for losses and is reduced through charge-offs. The Corporation's loss coverage ratio, measured as the ratio of the year-end allowance for losses to charge-offs in that year was 3.7:1 at December 31, 1996, compared with 4.6:1 at December 31, 1995. Changes in the allowance for losses for the years 1992 through 1996 are presented in the following table.

Allowance for Losses

	Total (Dollars in millions)
Balance, January 1, 1992	$ 704
Provisions for losses	320
Charge-offs:	
Single-family	(202)
Multifamily	(42)
Balance, December 31, 1992	780
Provisions for losses	175
Charge-offs:	
Single-family	(87)
Multifamily	(27)
Balance, December 31, 1993	841
Provisions for losses	155
Charge-offs:	
Single-family	(145)
Multifamily	(24)
Balance, December 31, 1994	827
Provisions for losses	140
Charge-offs:	
Single-family	(146)
Multifamily	(26)
Balance, December 31, 1995	795
Provisions for losses	195
Charge-offs:	
Single-family	(191)
Multifamily	(19)
Balance, December 31, 1996	$ 780

Balance Sheet Analysis

This section discusses the Corporation's mortgage portfolio and other investments and related financing activities. Also included is a discussion of liquidity and capital resources and regulatory capital requirements.

Mortgage Portfolio

As of December 31, 1996, the net mortgage portfolio totaled $286 billion, compared with $253 billion at December 31, 1995. The yield on the net mortgage portfolio was 7.69 percent at December 31, 1996, compared with 7.80 percent at December 31, 1995. The yield on the net mortgage portfolio averaged 7.71 percent in 1996, compared with 7.85 percent in 1995. The decline in the average yield was largely due to lower purchase yields relative to the yields on liquidations in 1996.

The following table summarizes mortgage purchases, sales and repayments for the years 1994 through 1996.

Mortgage Portfolio Activity

	Purchases			Sales			Repayments (1)		
	1996	1995	1994	1996	1995	1994	1996	1995	1994
				(Dollars in millions)					
Single-family:									
Government insured or guaranteed	$ 4,461	$ 2,669	$ 4,751	$ —	$ —	$ —	$ 1,650	$ 1,226	$ 1,617
Conventional:									
Long-term, fixed-rate	54,021	42,659	39,426	105	281	1,048	17,554	10,972	11,868
Intermediate-term, fixed-rate	8,139	9,235	15,378	44	126	726	10,564	8,545	11,110
Adjustable-rate	706	1,017	1,223	—	—	—	2,789	2,624	3,541
Second	17	11	8	—	—	—	117	125	248
Total single-family	67,344	55,591	60,786	149	407	1,774	32,674	23,492	28,384
Multifamily	1,274	1,007	1,603	—	11	28	2,254	1,235	1,008
Total	$68,618	$56,598	$62,389	$149	$418	$1,802	$34,928	$24,727	$29,392
Average net yield	7.57%	7.75%	7.75%				7.81%	7.90%	8.11%
Repayments as a percentage of average mortgage portfolio							12.9%	10.6%	14.2%

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

The increase in mortgage purchases during 1996 compared with 1995 was the result of more favorable spreads between mortgage yields and the Corporation's debt costs and an increase in the number of mortgages offered for sale in the secondary market. In periods when the spread between mortgage yields and the Corporation's cost of funds widens, the Corporation generally purchases more mortgage loans to be retained in its portfolio.

The increase in repayments during 1996 was primarily due to more refinancings in the early part of the year due to lower interest rates. The lower sales level in 1996 compared with 1995 reflected the more favorable mortgage-to-debt spread climate in 1996.

Investments

The Corporation maintains an investment portfolio consisting of high-quality, short-term, nonmortgage investments such as federal funds, commercial paper, repurchase agreements, asset-backed securities, and other investments. The objectives of the investment portfolio are to contribute to corporate profitability, serve as a source of liquidity and provide a return on the excess capital of the Corporation. The balance in the investment portfolio was $57 billion at both December 31, 1996 and

1995. The average rate earned on investment securities in 1996 was 5.68 percent, compared with 6.15 percent in 1995.

Additional information on these investments is presented in the Notes to Financial Statements, "Investments."

Financing Activities

The following table sets forth the amount and average cost of debt issued and repaid in 1996, 1995 and 1994, and the debt outstanding at the end of each of those years. The average cost of debt outstanding at December 31, 1996 was 6.49 percent, compared with 6.55 percent at December 31, 1995. The average cost of debt outstanding at December 31, 1996 declined as a result of the issuance of new debt at lower costs and the call and refunding of a substantial amount of higher cost debt when interest rates declined in early 1996.

Short-Term and Long-Term Debt Activity

	1996	1995	1994
	(Dollars in millions)		
Issued during the year:			
Short-term(1):			
Amount	$635,595	$699,311	$564,014
Average cost	5.36%	5.87%	4.58%
Long-term(1):			
Amount	$ 80,302	$ 49,922	$ 39,238
Average cost	6.17%	6.55%	6.19%
Repaid during the year:			
Short-term(1):			
Amount	$636,768	$678,989	$523,656
Average cost	5.41%	5.86%	4.21%
Long-term(1):			
Amount	$ 46,937	$ 28,391	$ 23,595
Average cost	6.93%	7.50%	8.19%
Outstanding at year-end:			
Due within one year:			
Net amount	$159,900	$146,153	$112,602
Average cost(2)	5.66%	5.90%	6.05%
Due after one year:			
Net amount	$171,370	$153,021	$144,628
Average cost(2)	6.66%	6.83%	6.97%
Total debt:			
Net amount	$331,270	$299,174	$257,230
Average cost(3)	6.49%	6.55%	6.78%

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

(3) Weighted-average cost includes the amortization of discounts, premiums, issuance costs and hedging results, and the effect of currency, debt, and interest rate swaps.

During 1996, the average cost of debt outstanding decreased .06 percentage points compared with 1995 due to the maturity or call of higher cost debt and lower interest rates on new debt issued. The average maturity of effective long-term, fixed-rate debt outstanding at both December 31, 1996 and 1995 was 64 months.

The Corporation also utilizes a Global Debt Facility through which it can issue debt securities in global markets. During 1996, the Corporation issued debt securities totaling $7 billion under its Global Debt Facility, compared with $6 billion in 1995.

As described under ''Interest Rate Risk Management,'' matching the duration of mortgage assets with the duration of liabilities funding those assets is accomplished through the use of different debt maturities and option characteristics, as well as the use of interest rate swaps.

The following table presents the amount of callable debt and the notional amount of callable interest rate swaps issued and outstanding for each of the past three years. The higher percentage of callable debt issued in 1996 compared with 1995 reflected market conditions and the ongoing restructuring of the Corporation's debt mix supporting the mortgage portfolio.

Callable Debt

	1996	1995	1994
	(Dollars in billions)		
Issued during the year	$ 44	$ 23	$ 22
Percentage of total long-term debt issued(1)	52%	37%	45%
Outstanding at year-end	$127	$106	$102
Percentage of total long-term debt outstanding(1)	48%	48%	55%

(1) Includes the notional amount of callable swaps and excludes long-term debt with a repricing frequency of one year or less.

Interest rate swaps increase the flexibility of the Corporation's funding alternatives by providing the specific cash flows or characteristics the portfolio requires but that might not be as readily available or cost-effective if obtained in the standard debt market. Fannie Mae does not speculate using derivatives and does not engage in trading of derivatives. The Corporation primarily uses two types of interest rate swaps—generic swaps, which involve the exchange of fixed and variable interest payments based on contractual notional principal amounts and may include callable swaps (which give the Corporation the right to terminate the interest rate swap agreement before its stated final maturity), and basis swaps, whereby the Corporation exchanges variable payments that have similar maturities but are based on different indices.

The following table summarizes the Corporation's interest rate swap activity for the years ended December 31, 1996 and 1995, together with the expected maturities and weighted-average interest rates to be received and paid on these swaps.

Interest Rate Swap Activity and Maturity Data

	Generic-pay fixed/receive variable (1)			Generic-pay variable/receive fixed					
	Notional (2)	Pay Rate (3)	Receive Rate (3)	Notional (2)	Pay Rate (3)	Receive Rate (3)	Basis Swaps	Other	Total
	(Dollars in millions)								
Balance at January 1, 1995	$ 55,169	6.89%	5.74%	$ 7,479	6.16%	6.57%	$22,405	$1,306	$ 86,359
Additions	26,020	6.46	5.93	9,777	5.76	6.96	16,985	—	52,782
Maturities	5,653	7.65	5.65	3,718	5.84	6.35	6,499	91	15,961
Balance at December 31, 1995	75,536	6.68	5.87	13,538	5.76	6.97	32,891	1,215	123,180
Additions	31,516	6.82	5.56	12,420	5.38	6.33	26,649	—	70,585
Maturities	6,941	6.59	5.50	10,334	5.67	6.90	19,665	1,012	37,952
Balance at December 31, 1996	$100,111	6.73%	5.59%	$15,624	5.43%	6.50%	$39,875	$ 203	$155,813
Future Maturities (4)									
1997	$ 11,020	6.10%	5.66%	$ 4,305	5.46%	6.10%	$31,085	$ 200	$ 46,610
1998	9,290	5.34	5.64	1,934	5.43	6.44	4,510	—	15,734
1999	6,431	6.66	5.26	5,085	5.43	6.18	2,910	—	14,426
2000	4,150	6.15	5.61	825	5.50	7.32	850	—	5,825
2001	7,850	6.67	5.55	800	5.48	6.58	—	—	8,650
Thereafter	61,370	7.11	5.62	2,675	5.32	7.53	520	3	64,568
	$100,111	6.73%	5.59%	$15,624	5.43%	6.50%	$39,875	$ 203	$155,813

(1) Included in the notional amounts are callable swaps of $28 billion and $23 billion with weighted-average pay rates of 6.68 percent and 6.38 percent, and weighted-average receive rates of 5.62 percent and 5.83 percent as of December 31, 1996 and 1995, respectively.

(2) The notional value only indicates the amount on which swap payments are being calculated and does not represent the amount at risk of loss.

(3) The weighted-average interest rate receivable and payable is as of the date indicated. Where the pay rate or receive rate is variable, the rate may change as prevailing interest rates change.

(4) Assumes that variable interest rates remain constant at December 31, 1996 levels.

The Corporation's interest rate swaps had a weighted-average term of 71 months at year-end 1996 and 70 months at year-end 1995. Long-term debt outstanding, including the effect of swaps but excluding effective variable-rate debt (*i.e.*, long-term debt that reprices within one year), totaled $267 billion at December 31, 1996, and $221 billion at December 31, 1995. Interest rate swaps effectively lengthened the final maturity of the Corporation's liabilities by 20 months at December 31, 1996 and 16 months at December 31, 1995.

The primary risk posed by the Corporation's interest rate swaps is credit risk, or the risk that a counterparty fails to meet its contractual obligations on a swap transaction, causing the Corporation to have to replace the swap at market prices. The Corporation manages this risk by dealing with experienced swap counterparties with high credit quality, diversifying its swaps across many counterparties, and entering into swaps under master agreements, which require counterparties to post collateral if the Corporation is exposed to credit loss on the related swaps exceeding an agreed-upon threshold. In addition, master agreements provide for netting of certain amounts payable by each party. Fannie Mae regularly monitors the exposures on its interest rate swaps by marking the positions to market via dealer quotes and internal pricing models. At December 31, 1996, no collateral was held for interest rate swaps.

The Corporation's off-balance sheet exposure on interest rate swaps (taking into account master agreements that allow for netting of payments) was $8 million at December 31, 1996, compared with $9 million at December 31, 1995.

The Corporation also hedges against fluctuations in interest rates on planned debt issuances through the sale and purchase of Treasury securities and through deferred rate setting agreements. Gains and losses on these instruments are deferred and reflected as basis adjustments to the cost of the debt. The hedging of planned debt issuances enables the Corporation to maintain an orderly and cost-effective debt issuance schedule, so that it can make daily loan purchase commitments without significantly increasing its interest rate exposure.

Additional information on interest rate swaps and other off-balance-sheet financial instruments is presented in the Notes to Financial Statements, "Financial Instruments with Off-Balance-Sheet Risk" and "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 mortgage loans. The Corporation, therefore, must raise funds continually to support its mortgage purchase activity. The capital markets traditionally have treated the Corporation's obligations as "federal agency" debt. As a result, even though Fannie Mae's debt is not guaranteed by the U.S. government, the Corporation has had ready access to funding at relatively favorable rates.

Fannie Mae's primary sources of cash are issuances of debt obligations, mortgage loan repayments, interest income and MBS guaranty fees. In addition, Fannie Mae had cash and a portfolio of cash equivalents and shorter-term investments totaling $57 billion and $58 billion at December 31, 1996 and 1995, respectively. Primary uses of cash include the purchase of mortgages, repayment of debt, interest payments, administrative expenses and taxes.

At December 31, 1996, the Corporation had mandatory delivery commitments and lender-option commitments outstanding to purchase $1.9 billion and $1.2 billion of mortgage loans, respectively, compared with $2.5 billion and $1.5 billion, respectively, outstanding at December 31, 1995.

In 1996, Fannie Mae successfully completed the first phase of the capital restructuring program announced at the end of 1995. This phase included a four-for-one split in the Corporation's common stock which became effective January 16, 1996; the contribution of $350 million in Fannie Mae common stock to the Fannie Mae Foundation; and the issuance of $1 billion in preferred stock. Also as part of the restructuring program, the Board of Directors authorized repurchase of up to an additional 6 percent of the outstanding common shares at the time of the announcement (adjusted for the stock split). As of December 31, 1996, the Corporation had not purchased any stock against this authorization.

The Corporation repurchased 48 million shares of common stock during 1996 in order to fund the contribution to the Fannie Mae Foundation, fully utilize the proceeds of the issuance of $1 billion in preferred stock, and offset the effect of shares issued in conjunction with various stock compensation plans.

The Corporation's capital base (stockholders' equity plus general allowance for losses) grew to $13.5 billion at December 31, 1996, compared with $11.7 billion at the end of 1995. At year-end 1996, there were 1.061 billion shares of common stock outstanding. In January 1997, the Board approved a quarterly dividend rate for 1997 of 21 cents per common share. In 1996, the quarterly dividend rate was 19 cents per common share.

Regulatory Capital Requirements

The Corporation is subject to capital adequacy and risk-based standards established by the 1992 Act. The capital adequacy standards require the Corporation's core capital to equal or exceed a minimum capital standard and a critical capital standard. See "Government Regulation and Charter Act." The following table shows the Corporation's core capital compared with the requirement.

Capital Requirements

	December 31,	
	1996	1995
	(Dollars in millions)	
Core capital(1)	$12,773	$10,959
Required minimum capital(2)	11,466	10,451
Required critical capital(3)	5,890	5,373
Excess of core capital over minimum capital	$ 1,307	$ 508

(1) The sum of (a) the par value of outstanding common stock; (b) the par 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, except as adjusted 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, except as adjusted by the Director of OFHEO.

The Director of OFHEO also is developing a risk-based standard consistent with the parameters specified in the 1992 Act. The risk-based standard includes credit and interest rate risk components, along with an additional amount of capital for management and operations risk. To meet that standard, the Corporation must hold total capital equal to the amount necessary to meet the combined occurrence of highly stressful credit and interest rate conditions over a ten-year period, plus an additional 30 percent of this amount for management and operations risk.

In 1996, the Director of OFHEO issued the first of two proposals relating to the risk-based regulation. The first part creates benchmarks for credit stress testing and specifies the housing price index that will be used in connection with this standard. The second part of the proposed regulation, which is expected to be issued for public comment in 1997, will propose the remaining credit risk criteria and the interest rate risk criteria. See "Government Regulation and Charter Act." The 1992 Act provides that the final regulations will be enforceable one year after issuance.

Mortgage-Backed Securities

MBS outstanding grew to $651 billion at December 31, 1996, compared with $583 billion at December 31, 1995. MBS are backed by loans from a single lender, multiple lenders, or from the Corporation's mortgage portfolio. Single-lender MBS 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 receive, in return, MBS representing a proportionate share of a larger pool (called Fannie Majors®). In some instances, the Corporation buys loans, and at the same time, enters into a forward sale commitment. These loans are designated as available-for-sale and sold from the portfolio as MBS.

MBS frequently are used to back other securities, including Fannie Megas, SMBS and REMICs. In both 1996 and 1995, Fannie Mae issued REMIC securities and SMBS backed by REMICs, SMBS or mixed mortgage securities. Fannie Megas allow investors to consolidate small or partially paid down pools of MBS of the same type and pass-through rate. In return, the investor receives a certificate representing an undivided interest in the consolidated pool.

MBS are not assets of the Corporation, except when acquired for investment purposes, nor are MBS recorded as liabilities. However, the Corporation is liable under its guarantee to make timely payment of principal and interest to investors. The issuance of MBS creates guaranty fee income for Fannie Mae. Sellers of pools of mortgage loans may retain or transfer to one or more third parties the

primary default risk on loans comprising the MBS pools, or they may elect to transfer this credit risk to Fannie Mae. The guaranty fee paid by the lender varies depending upon the risk profile of the loans securitized, as well as the level of credit risk assumed by Fannie Mae. The Corporation, however, assumes the ultimate risk of loss on all MBS.

The following table summarizes MBS issued and outstanding for the years ended December 31, 1996, 1995, and 1994. The increase in MBS issued in 1996 compared with 1995 was primarily due to lower interest rates in the first few months of 1996, which resulted in higher mortgage originations and an increase in the secondary mortgage market supply of mortgage loans.

MBS Risk Distribution

	Issued				Outstanding (1)		
	Lender Originated (1)						
	Lender Risk	Fannie Mae Risk	Fannie Mae Originated	Total	Lender Risk (2)	Fannie Mae Risk	Total (3)
	(Dollars in millions)						
1996	$13,389	$135,677	$ 803	$149,869	$70,642	$580,138	$650,780
1995	16,681	93,359	416	110,456	67,080	515,879	582,959
1994	11,698	114,526	4,398	130,622	58,565	471,778	530,343

(1) Based on primary default risk category. MBS outstanding includes MBS that have been pooled to back Megas, SMBS, or REMICs.

(2) Included in lender risk are $31 billion, $30 billion and $31 billion at December 31, 1996, 1995 and 1994, respectively, on which the lender or a third party had agreed to bear default risk limited to a certain portion or percentage of the loans delivered and, in some cases, the lender had pledged collateral to secure that obligation.

(3) Included are $103 billion, $70 billion and $44 billion at December 31, 1996, 1995 and 1994, respectively, of MBS in Fannie Mae's portfolio.

In 1996, REMIC issuances increased to $27 billion, compared with $8 billion in 1995. The increase was primarily due to a steeper yield curve.

Fannie Mae has issued REMICs backed by MBS, Ginnie Mae mortgage-backed securities, or whole loans. REMICs provide an additional source of fee income that does not subject the Corporation to added credit risk, except for REMICs backed by whole loans. The outstanding balance of REMICs at December 31, 1996 was $283 billion, compared with $294 billion at December 31, 1995.

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 purchase and funding activities for the Corporation's mortgage and nonmortgage investment portfolios. Income primarily is derived from the difference, or spread, between the yield on mortgage loans and nonmortgage 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 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 comparable to what it would charge on an MBS. Net interest income for the Credit Guaranty business also includes interest on capital invested in credit guaranty activities and income from temporary investment of principal and interest payments on guaranteed mortgages prior to remittance to investors, and is net of interest charges paid to the Portfolio Investment business for delinquent loans.

The Corporation 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 based on direct expenses for the line of business, or, where not identifiable to a particular associated business, are based on revenues, profits, or volumes, as applicable. Capital is allocated to the separate businesses based on an assessment of the interest rate and credit risk associated with each business.

The following table sets forth the Corporation's financial performance by line of business for the years ended December 31, 1996, 1995, and 1994.

Line of Business

	1996			1995				1994		
	Portfolio Investment	Credit Guaranty	Total	Portfolio Investment	Credit Guaranty	Special Contribution	Total	Portfolio Investment	Credit Guaranty	Total
					(Dollars in millions)					
Net interest income	$3,180	$ 412	$ 3,592	$2,640	$ 407	—	$3,047	$2,474	$ 349	$ 2,823
Guaranty fees	(730)	1,926	1,196	(630)	1,716	—	1,086	(573)	1,656	1,083
Miscellaneous, net	32	54	86	22	71	—	93	11	132	143
Credit-related expenses	—	(409)	(409)	—	(335)	—	(335)	—	(378)	(378)
Administrative expenses	(130)	(430)	(560)	(132)	(414)	—	(546)	(106)	(419)	(525)
Special contribution	—	—	—	—	—	(350)	(350)	—	—	—
Federal income taxes	(661)	(490)	(1,151)	(520)	(442)	122	(840)	(542)	(463)	(1,005)
Extraordinary item—early extinguishment of debt	(29)	—	(29)	(11)	—	—	(11)	(9)	—	(9)
Net income	$1,662	$1,063	$ 2,725	$1,369	$1,003	$(228)	$2,144	$1,255	$ 877	$ 2,132

Housing Goals

The 1992 Act gives the Secretary of HUD authority to establish low- and moderate-income, underserved areas and special affordable housing goals for Fannie Mae. In December 1995, the Secretary of HUD issued final regulations regarding the Corporation's housing goals for 1996-1999. Under the new regulations, the Corporation's 1996 target goal in low- and moderate-income housing increased to 40 percent of the Corporation's conventional mortgage business from 30 percent in 1995. The 1996 geographic goal, based on underserved census tracts in metropolitan statistical areas ("MSAs") and counties in rural areas, was 21 percent of the Corporation's conventional mortgage business. The special affordable housing goal, which serves very low-income families and low-income families in low-income areas, was 12 percent of the Corporation's 1996 single-family conventional mortgage business and multifamily business. In addition, the Corporation must include mortgage purchases of multifamily units totaling no less than $1.3 billion (.8 percent of total dollar volume of the Corporation's business in 1994). All of these goals are measured as a percent of dwelling units financed.

In 1996 and 1995, the Corporation exceeded its low- and moderate-income housing goal with 45.4 percent and 46.2 percent, respectively, of its conventional mortgage business counting towards this goal. In 1996, the Corporation exceeded its geographic goal with 28.2 percent of its conventional mortgage business counting towards this goal. The Corporation exceeded the 1995 central cities goal (replaced in 1996 by the geographic goal) with 30.4 percent of the conventional mortgage business serving families in central cities. In addition, in 1996 the Corporation exceeded its special affordable housing goal with 17.4 percent of the conventional single-family and multifamily business counting towards this goal and with $2.4 billion of multifamily business meeting the $1.3 billion multifamily requirement. In 1995, the Corporation exceeded the special affordable housing one-year goal of $4.6 billion of single-family and multifamily purchases by $3.8 billion.

Under the new regulations, the low- and moderate-income target and the geographic goal will increase to 42 percent and 24 percent, respectively, in 1997-1999. In addition, the special affordable housing goal will require the Corporation to target 14 percent of its conventional mortgage business in the 1997-1999 period to very low-income households or low-income households living in low-income

areas. The Corporation also will be required to maintain the $1.3 billion of special affordable multifamily business for each year during this period.

Fannie Mae has built a solid foundation in affordable housing through significant consumer outreach efforts, products directed at certain disadvantaged groups, and the introduction of products with targeted underwriting flexibility, including an initiative to purchase loans with lower down payments to aid low-income households in affording homes. In 1994, the Corporation introduced an initiative to provide $1 trillion from 1994 through the year 2000 to finance homes for families and communities most in need. This targeted housing finance initiative will serve 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. By the end of the decade, the initiative is intended to show an additional ten million families a way to achieve the American dream of homeownership.

New Accounting Standard

During 1996, the Financial Accounting Standards Board issued Financial Accounting Standard No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities" ("FAS 125").

FAS 125 requires that transfers of financial assets in which the transferor surrenders control be accounted for as a sale. It also requires that interest-only securities, loans or retained interests in securitizations that can be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment be classified as available-for-sale or trading. While FAS 125 is effective beginning in 1997, the provisions relating to treatment of repurchase agreements, mortgage dollar rolls, securities lending and similar transactions will not take effect until the beginning of 1998. In management's opinion, FAS 125 will not have a material impact on the Corporation.

Comparison of 1995 versus 1994

The following discussion and analysis provides a comparison of the Corporation's results of operations for the years ended December 31, 1995 and 1994.

Results of Operations

Net income in 1995 increased to $2.144 billion from $2.132 billion in 1994, while earnings per common share increased to $1.95 from $1.94 in 1994. Excluding the effect of a special fourth quarter contribution to the Fannie Mae Foundation, net income would have been $2.372 billion, or $2.15 per common share, in 1995.

Net interest income increased $224 million to $3.047 billion in 1995 due primarily to a $27 billion, or 13 percent, increase in the average mortgage portfolio balance outstanding during 1995 and an increase in income from tax-advantaged investments. The average net interest margin decreased .08 percentage points to 1.16 percent in 1995, compared with 1.24 percent in 1994. Two primary factors causing the decline were a substantial rise in the balance of shorter term, nonmortgage securities with significantly lower margins than those earned on the mortgage portfolio, and lower MBS float balances due to a reduction in MBS prepayments in early 1995. Nonperforming loans outstanding totaled $2.1 billion at the end of both 1995 and 1994. If nonperforming assets had been fully performing, they would have contributed an additional $122 million to net interest income in 1995 and $133 million in 1994.

Guaranty fee income remained relatively flat in 1995 compared with 1994 as an increase in average net MBS outstanding was offset by a lower effective guaranty fee rate. The decline in the effective guaranty fee rate was due primarily to an increase in the percentage of lender risk or credit-enhanced MBS issued, which generally have lower guaranty fee rates, and to competitive pressures.

The 35 percent decline in miscellaneous income during 1995 was primarily the result of a $36 million decrease from a change in accounting method for equity investments in affordable housing projects and a $27 million decrease in REMIC fee income due to lower REMIC issuance volume.

Credit-related expenses were $335 million in 1995, compared with $378 million in 1994. Credit-related expenses declined in 1995 in spite of an increase in the number of acquired properties due to a lower average loss per foreclosed property and a reduction in the provision for losses.

Administrative expenses totaled $546 million in 1995, compared with $525 million in 1994. Compensation expense was $312 million in 1995, compared with $293 million in 1994. The ratio of administrative expenses to the average net mortgage portfolio plus average net MBS outstanding was .075 percent in 1995, compared with .076 percent in 1994. The ratio of administrative expenses to revenues (net interest income, guaranty fees, and miscellaneous income) was 12.9 percent in 1995, compared with 13.0 percent in 1994.

In December 1995, the Corporation announced a commitment to contribute $350 million in Fannie Mae common stock to the Fannie Mae Foundation. This commitment resulted in a pretax charge to fourth quarter earnings of $350 million ($228 million after tax).

The provision for federal income taxes, net of the tax benefit from extraordinary losses, was $834 million in 1995, compared with $999 million in 1994. The effective federal income tax rate was 28 percent in 1995, a decrease from 32 percent in 1994. The decrease from the previous year was due to a favorable settlement with the IRS of several items relating to the 1986 and 1987 tax years, higher income on tax-advantaged investments, and the impact of tax credits from equity investments in affordable housing projects.

During 1995, the amount of long-term debt called or repurchased and the notional principal amount of interest rate swaps called was $19.7 billion with a weighted-average cost of 7.24 percent, compared with $14.1 billion with a weighted-average cost of 8.42 percent in 1994. As a result of this repurchase and call activity, the Corporation recognized net extraordinary losses of $17 million ($11 million after tax) in 1995, compared with $15 million ($9 million after tax) in 1994.

FANNIE MAE

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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, 1996 and 1995, 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, 1996. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. 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, 1996 and 1995, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 1996, in conformity with generally accepted accounting principles.

We also have audited in accordance with generally accepted auditing standards the supplemental fair value balance sheets of Fannie Mae as of December 31, 1996 and 1995, included in Note 13 to the financial statements. 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 generally accepted accounting principles. 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 from the fair values presented. In our opinion, the supplemental fair value balance sheets included in Note 13 present fairly, in all material respects, the information set forth therein on the basis of accounting described in Note 13.

KPMG Peat Marwick LLP

Washington, DC
January 14, 1997

FANNIE MAE

STATEMENTS OF INCOME

	Year Ended December 31,		
	1996	1995	1994
	(Dollars in millions, except per share amounts)		
Interest income:			
Mortgage portfolio	$20,560	$18,154	$15,851
Investments and cash equivalents	3,212	2,917	1,496
Total interest income	23,772	21,071	17,347
Interest expense:			
Short-term debt	3,395	3,994	2,315
Long-term debt	16,785	14,030	12,209
Total interest expense	20,180	18,024	14,524
Net interest income	3,592	3,047	2,823
Other income:			
Guaranty fees	1,196	1,086	1,083
Miscellaneous, net	86	93	143
Total other income	1,282	1,179	1,226
Other expenses:			
Provision for losses	195	140	155
Foreclosed property	214	195	223
Administrative	560	546	525
Special contribution	—	350	—
Total other expenses	969	1,231	903
Income before federal income taxes and extraordinary item	3,905	2,995	3,146
Provision for federal income taxes	1,151	840	1,005
Income before extraordinary item	2,754	2,155	2,141
Extraordinary loss—early extinguishment of debt (net of tax effect of $16 million in 1996, and $6 million in 1995 and 1994)	29	11	9
Net income	$ 2,725	$ 2,144	$ 2,132
Preferred stock dividends	42	—	—
Net income available to common stockholders	$ 2,683	$ 2,144	$ 2,132
Per common share:			
Earnings before extraordinary item	$ 2.50	$ 1.96	$ 1.95
Net earnings	2.48	1.95	1.94
Cash dividends	.76	.68	.60
Average shares outstanding used to compute earnings per common share (in millions)	1,083	1,102	1,098

See Notes to Financial Statements

FANNIE MAE

BALANCE SHEETS

Assets

	December 31,	
	1996	1995
	(Dollars in millions)	
Mortgage portfolio, net	$286,259	$252,588
Investments	56,606	57,273
Cash and cash equivalents	850	318
Accrued interest receivable	2,419	2,247
Acquired property and foreclosure claims, net	954	638
Other	3,953	3,486
Total assets	$351,041	$316,550

Liabilities and Stockholders' Equity

	1996	1995
Liabilities:		
Debentures, notes and bonds, net:		
Due within one year	$159,900	$146,153
Due after one year	171,370	153,021
Total	331,270	299,174
Accrued interest payable	4,236	3,817
Other	2,762	2,600
Total liabilities	338,268	305,591
Stockholders' Equity:		
Preferred stock, $50 stated value, 100 million shares authorized— 20 million shares issued (1996)	1,000	—
Common stock, $.525 stated value, no maximum authorization— 1,129 million shares issued (1996 and 1995)	593	593
Additional paid-in capital	1,451	1,389
Retained earnings	11,214	9,348
	14,258	11,330
Less: Treasury stock, at cost, 68 million shares (1996) and 37 million shares (1995)	1,485	371
Total stockholders' equity	12,773	10,959
Total liabilities and stockholders' equity	$351,041	$316,550

See Notes to Financial Statements

FANNIE MAE

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Number of Shares Outstanding (1)	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Total Stockholders' Equity
	(Dollars and shares in millions)						
Balance, January 1, 1994	272	$ —	$593	$1,308	$ 6,470	$ (319)	$ 8,052
Net income	—	—	—	—	2,132	—	2,132
Dividends	—	—	—	—	(656)	—	(656)
Shares repurchased	(1)	—	—	—	—	(67)	(67)
Treasury stock issued for stock options and benefit plans	2	—	—	57	—	36	93
Securities available for sale, market value adjustment, net of tax effect	—	—	—	—	(13)	—	(13)
Balance, December 31, 1994	273	—	593	1,365	7,933	(350)	9,541
Four-for-one stock split	818	—	—	—	—	—	—
Net income	—	—	—	—	2,144	—	2,144
Dividends	—	—	—	—	(741)	—	(741)
Shares repurchased	(2)	—	—	—	—	(46)	(46)
Treasury stock issued for stock options and benefit plans	3	—	—	24	—	25	49
Securities available for sale, market value adjustment, net of tax effect	—	—	—	—	12	—	12
Balance, December 31, 1995	1,092	—	593	1,389	9,348	(371)	10,959
Net income	—	—	—	—	2,725	—	2,725
Dividends	—	—	—	—	(857)	—	(857)
Shares repurchased	(48)	—	—	—	—	(1,536)	(1,536)
Preferred stock issued	—	1,000	—	(20)	—	—	980
Contribution to Foundation	11	—	—	12	—	338	350
Treasury stock issued for stock options and benefit plans	6	—	—	70	—	84	154
Securities available for sale, market value adjustment, net of tax effect	—	—	—	—	(2)	—	(2)
Balance, December 31, 1996	1,061	$1,000	$593	$1,451	$11,214	$(1,485)	$12,773

(1) Number of shares for the year ended December 31, 1994 reflect a pre-split basis.

See Notes to Financial Statements

FANNIE MAE

STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	1996	1995	1994
	(Dollars in millions)		
Cash flows from operating activities:			
Net income	$ 2,725	$ 2,144	$ 2,132
Adjustments to reconcile net income to net cash provided by operating activities:			
Discount amortization on short-term debt	4,338	5,070	2,965
Provision for losses	195	140	155
Loss on early extinguishment of debt	45	17	15
Other decreases, net	(830)	(922)	(3,508)
Net cash provided by operating activities	6,473	6,449	1,759
Cash flows from investing activities:			
Purchases of mortgages	(68,471)	(56,738)	(61,491)
Proceeds from sales of mortgages	102	408	1,819
Mortgage principal repayments	32,853	23,062	27,902
Net proceeds from disposition of foreclosed properties	2,448	1,968	2,001
Net decrease (increase) in investments	667	(10,937)	(24,939)
Net cash used in investing activities	(32,401)	(42,237)	(54,708)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt	79,189	50,039	39,181
Payments to redeem long-term debt	(46,966)	(28,620)	(23,605)
Proceeds from issuance of short-term debt	606,427	694,962	567,026
Payments to redeem short-term debt	(610,876)	(679,754)	(529,746)
Net payments from stock activities	(1,314)	(752)	(653)
Net cash provided by financing activities	26,460	35,875	52,203
Net increase (decrease) in cash and cash equivalents	532	87	(746)
Cash and cash equivalents at beginning of year	318	231	977
Cash and cash equivalents at end of year	$ 850	$ 318	$ 231
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	$ 19,526	$ 16,076	$ 13,940
Income taxes	1,053	666	1,007

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 the Corporation conform with generally accepted accounting principles. Certain amounts in prior years' financial statements have been reclassified to conform with the current presentation.

The preparation of financial statements in conformity with generally accepted accounting principles 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 and Investments

Mortgages and mortgage-backed securities that the Corporation has the ability and positive intent to hold to maturity are classified as held to maturity and are carried at their unpaid principal balances adjusted for unamortized purchase discount or premium and deferred loan fees. 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 the Corporation intends to hold for an undetermined period of time, but not necessarily to maturity, are classified as available for sale and are carried at fair value, with any valuation adjustments reported in retained earnings, net of deferred taxes.

The Corporation 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 loan fees and purchase discount or premium. 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.

The accrual of interest on conventional mortgages (*i.e.*, mortgages that are not federally insured or guaranteed) is discontinued when the mortgages become 90 days or more delinquent. Any accrued but uncollected interest on mortgages that are 90 days delinquent is reversed against current period interest income. Interest income on such mortgages is recognized only to the extent that cash payments are received.

Nonmortgage investments are carried at their historical cost adjusted for unamortized discount or premiums, because the Corporation has the ability and positive intent to hold these investments until their maturity. Available-for-sale securities are reported at fair value with unrealized gains and losses reported in retained earnings, net of deferred taxes.

Guaranteed Mortgage-Backed Securities

The Corporation guarantees the timely payment of principal and interest on Fannie Mae Mortgage-Backed Securities ("MBS"). These securities represent beneficial interests in pools of mortgages or other mortgage-backed securities held in trust by the Corporation. The pools of mortgages or mortgage-backed securities are not assets of the Corporation, except when acquired for investment purposes, nor are the related outstanding securities liabilities; accordingly, neither is reflected on the accompanying balance sheets. The Corporation 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 the Corporation's portfolio, the guaranty fee is reflected as interest income.

Allowance for Losses

The allowance for losses is based on an analysis of the mortgage portfolio and MBS outstanding, and provides for future foreclosure losses. The analysis considers credit profile factors such as mortgage characteristics, geographic concentrations, economic conditions, and actual and expected loan loss experience. The allowance is increased by provisions charged as an expense in the income statement and reduced by charge-offs, net of recoveries. In management's judgment, the allowance for losses is adequate to provide for expected losses.

Acquired Property

Foreclosed assets are recorded at the lower of cost or fair value less estimated costs to sell. Cost is defined as fair value at 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 fair value at foreclosure and the principal owed is recorded as a charge-off. Foreclosure, holding, and disposition costs are charged directly to earnings as incurred.

Interest Expense and Risk Management Activities

Classification of interest expense as short-term or long-term is based on effective maturity or repricing date, taking into consideration the effect of interest rate swaps. The difference between the interest rates paid and received on interest rate swaps is recognized as an adjustment to interest income or expense on the related assets or liabilities over their expected lives.

The Corporation takes positions in financial markets to hedge against changing interest rates or foreign currency fluctuations that may affect the cost of certain debt issuances. Results from activities that are designated and perform effectively as hedges are deferred and amortized as adjustments to interest expense over the term of the borrowing.

Foreign Currency Translation

The Corporation 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, the Corporation enters into currency swaps that convert the proceeds of certain borrowings into dollars or provide for scheduled future exchanges of the currencies to insulate the Corporation against foreign exchange risk.

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.

Cash and Cash Equivalents

The Corporation 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 market 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 deferred and amortized over the lives of the related assets.

Earnings Per Common Share

Earnings per common share are computed using the weighted-average number of common shares outstanding, including the fully dilutive effects of common stock equivalents and assuming that all outstanding subordinated convertible capital debentures were converted at the beginning of the year, after increasing earnings for the related interest expense, net of federal income taxes. Common shares issuable under employee stock benefit plans and for subordinated convertible capital debentures do not have a material effect on earnings per common share.

2. Mortgage Portfolio, Net

The mortgage portfolio consisted of the following at December 31, 1996 and 1995.

	1996	1995
	(Dollars in millions)	
Single-family mortgages:		
Government insured or guaranteed	$ 15,912	$ 13,102
Conventional:		
Long-term, fixed-rate	177,070	140,466
Intermediate-term, fixed-rate(1)	66,284	68,752
Adjustable-rate	12,783	15,108
Second	323	423
	272,372	237,851
Multifamily mortgages:		
Government insured	3,673	3,659
Conventional	11,007	12,001
	14,680	15,660
Total unpaid principal balance	287,052	253,511
Less:		
Unamortized discount and deferred loan fees, net	524	643
Allowance for losses	269	280
Net mortgage portfolio	$286,259	$252,588

(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 $119 billion and $82 billion of MBS and other mortgage-related securities at December 31, 1996 and 1995, with fair values of $120 billion and $84 billion, respectively. Mortgage assets available for sale were $.1 billion at December 31, 1996 and 1995.

MBS held in portfolio at December 31, 1996 and 1995 included $22 billion and $18 billion, respectively, of Real Estate Mortgage Investment Conduits ("REMICs") and Stripped MBS ("SMBS"). REMICs and SMBS have the same types of credit risk as whole loans and MBS, but generally have different interest rate risks. At December 31, 1996, these securities had aggregate gross unrealized losses of $218 million and gross unrealized gains of $669 million. At December 31, 1995, the aggregate gross unrealized losses and gross unrealized gains were $613 million and $659 million, respectively.

The unpaid principal balance ("UPB") of impaired loans at December 31, 1996 was $445 million of which $221 million had a related specific loss allowance, compared with $399 million and $299 million, respectively, at December 31, 1995. The average balance of impaired loans during 1996 and 1995 was $421 million and $227 million, respectively.

Interest income on modified loans is recognized using the interest method based on the effective interest rate of the loans prior to restructuring. Income on impaired multifamily loans is recognized only to the extent cash is received.

3. Allowance for Losses

Changes in the allowance for the years 1994 to 1996 are summarized below.

	Total (Dollars in millions)
Balance, January 1, 1994	$ 841
Provision	155
Net foreclosure losses charged off	(169)
Balance, December 31, 1994	827
Provision	140
Net foreclosure losses charged off	(172)
Balance, December 31, 1995	795
Provision	195
Net foreclosure losses charged off	(210)
Balance, December 31, 1996	$ 780

At December 31, 1996, $269 million of the allowance for losses is included in the Balance Sheet under "Mortgage portfolio, net," which represents the allocation for portfolio loan losses; $507 million is included under "Other liabilities" for estimated losses on MBS; and the remainder, or $4 million, which relates to unrecoverable losses on FHA loans, is included in "Acquired property and foreclosure claims, net." The corresponding amounts at December 31, 1995 were $280 million, $510 million, and $5 million, respectively. Included in the allowance for losses at December 31, 1996 is $33 million of specific allowances for impaired loans, compared with $51 million in 1995. During 1996, the Corporation established $20 million of specific allowances for these loans, compared with $100 million in 1995.

4. Investments

Presented below are the amortized cost and fair value of nonmortgage investments at December 31, 1996 and 1995.

	1996				1995			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in millions)							
Eurodollar time deposits	$13,956	$—	$—	$13,956	$10,787	$—	$—	$10,787
Asset-backed securities	12,777	15	—	12,792	9,905	30	—	9,935
Federal funds	7,778	—	—	7,778	8,988	2	—	8,990
Commercial paper	6,191	1	—	6,192	8,629	3	—	8,632
Repurchase agreements	4,667	—	—	4,667	10,175	—	—	10,175
Other	11,237	6	4	11,239	8,789	17	13	8,793
Total	$56,606	$22	$ 4	$56,624	$57,273	$52	$13	$57,312

The following table shows nonmortgage investments at December 31, 1996 and 1995 by remaining maturity with the amortized cost, fair value, and yield.

	1996			1995		
	Amortized Cost	Fair Value	Yield	Amortized Cost	Fair Value	Yield
	(Dollars in millions)					
Due within one year	$38,624	$38,623	5.84%	$44,865	$44,857	5.73%
Due after one year through five years	4,219	4,223	5.83	2,503	2,520	6.29
Due after five years	986	986	5.35	—	—	—
	43,829	43,832	5.83	47,368	47,377	5.76
Asset-backed securities(1)	12,777	12,792	5.95	9,905	9,935	5.80
Total	$56,606	$56,624	5.86%	$57,273	$57,312	5.77%

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

5. Debentures, Notes, and Bonds, Net

Borrowings Due Within One Year

Borrowings due within one year at December 31, 1996 and 1995 are summarized below. Amounts are net of unamortized discount and premium.

	1996					1995				
	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	$ 90,166	5.48%	$80,013	5.42%	$90,166	$ 88,826	5.69%	$84,886	5.98%	$90,913
Other short-term debt	30,494	5.47	32,305	5.48	34,681	31,067	5.71	15,557	5.90	31,067
Current portion of borrowings due after one year(2):										
Debentures	8,553	7.89				10,944	8.24			
Other	30,687	5.73				15,316	5.86			
Total due within one year	$159,900	5.65%				$146,153	5.90%			

(1) Represents weighted-average cost, which includes the amortization of discounts, premiums, issuance costs and 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 consisted of the following at December 31, 1996 and 1995.

	Maturity Date	1996 Amount Outstanding	1996 Average Cost (1)	1995 Amount Outstanding	1995 Average Cost (1)
		(Dollars in millions)			
Debentures, net of $161 million of discount for 1996 ($175 million for 1995)	1997-2022	$ 65,186	7.03%	$ 69,146	7.39%
Medium-term notes, net of $142 million of discount for 1996 ($82 million for 1995)	1997-2026	104,618	6.37	82,158	6.28
Zero-coupon securities and subordinated capital debentures, net of $11,208 million of discount for 1996 ($11,366 million for 1995)	1997-2019	1,557	10.65	1,401	10.64
Long-term other, net of $50 million of discount for 1996 ($53 million for 1995)	1997-2018	198	9.99	203	9.99
		171,559	6.66%	152,908	6.83%
Adjustment for foreign currency translation		(189)		113	
Total due after one year		$171,370		$153,021	

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

Debentures, notes, and bonds at December 31, 1996 included $99 billion of callable debt, which generally is redeemable in whole or in part (and, in certain cases, at a specified premium), at the option of the Corporation any time on or after a specified date, and $.7 billion of other debt instruments that are subject to mandatory redemptions tied to certain indices or rates after an initial nonredemption period.

The following table summarizes the amounts and call periods of callable debt, the notional amount of callable swaps, and other redeemable debt and swaps. Medium-term notes and subordinated capital debentures that are redeemable at the Corporation's option also are included in the table.

Call Date	Year of Maturity	Amount Outstanding	Average Cost
	(Dollars in millions)		
Callable debt and callable swaps (notional amount):			
Currently callable	1997-2021	$ 31,621	5.59%
1997	1998-2021	32,470	6.98
1998	2000-2022	29,745	6.78
1999	2001-2024	19,462	7.38
2000	2001-2026	3,625	7.62
2001	2003-2026	8,967	7.33
2002 and later	2003-2011	278	6.90
		126,168	6.69
Other redeemable debt and swaps	1997-2001	650	6.86
Total		$126,818	6.69%

Principal amounts at December 31, 1996, of total debt payable in the years 1998-2002 assuming callable debt is paid at maturity and assuming callable debt is redeemed at the initial call date are as follows:

	Total Debt by Year of Maturity	Assuming Callable Debt Redeemed at Initial Call Date
	(Dollars in millions)	
1998	$37,025	$40,030
1999	24,965	34,732
2000	18,317	13,049
2001	23,618	10,916
2002	6,875	1,625

In 1996 and 1995, the Corporation repurchased or called $26 billion of debt and swaps with an average cost of 7.09 percent and $20 billion with an average cost of 7.24 percent, respectively. The Corporation recorded extraordinary losses of $45 million ($29 million after tax) in 1996 and $17 million ($11 million after tax) in 1995 on the early extinguishment of debt.

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

6. Income Taxes

Components of the provision for federal income taxes for the years ended December 31, 1996, 1995 and 1994 were as follows:

	1996	1995	1994
	(Dollars in millions)		
Current	$1,109	$819	$1,083
Deferred	42	21	(78)
	1,151	840	1,005
Tax benefit of extraordinary loss	(16)	(6)	(6)
Net federal income tax provision	$1,135	$834	$ 999

The tax effects of temporary differences that gave rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 1996 and 1995 consisted of the following:

	1996	1995
	(Dollars in millions)	
Deferred tax assets:		
MBS guaranty and REMIC fees	$373	$342
Provision for losses	311	317
Contribution carryover	—	30
Other items, net	49	50
Deferred tax assets	733	739
Deferred tax liabilities:		
Benefits from tax-advantaged investments	142	134
Purchase discount and deferred fees	20	26
Other items, net	26	21
Deferred tax liabilities	188	181
Net deferred tax assets	$545	$558

Management anticipates that the entire balance of deferred tax assets will be recognized in future periods.

The Corporation's effective tax rates differed from statutory federal rates for the years ended December 31, 1996, 1995, and 1994 as follows:

	1996	1995	1994
Statutory corporate rate	35%	35%	35%
Tax-exempt interest and dividends received deductions	(4)	(4)	(3)
Equity investments in affordable housing projects	(2)	(2)	—
Settlement of IRS issues	—	(1)	—
Effective rate	29%	28%	32%

The Corporation is exempt from state and local taxes, except for real estate taxes.

7. Stock Compensation Plans

At December 31, 1996, the Corporation had five stock-based compensation plans which are described below. Financial Accounting Standard No. 123 ("FAS 123") provides companies the option of either recording an expense for all stock compensation awards based on fair values at grant date, or electing to continue to follow Accounting Principles Board Opinion No. 25 ("APB Opinion 25") with the additional requirement that they disclose, in a footnote, pro forma 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. Accordingly, no compensation expense has been recognized for the nonqualified stock options and employee stock purchase plan. Had compensation expense been recognized for benefits under all five plans, based on their fair value at grant date and consistent with FAS 123, the effect on 1996, 1995 and 1994 net income and earnings per common share would have been immaterial.

Performance Shares

Fannie Mae's Stock Compensation Plans authorize eligible employees to receive performance awards, generally issued within an award period that can range from three to five years. The performance awards become actual awards only if the Corporation attains the goals set for the award period. At the end of such time, the awards generally are payable in common stock. The outstanding contingent grants made for the 1997-1999, 1996-1998, and 1995-1997 periods were 247,540 shares, 353,800 shares, and 461,840 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 and generally expire ten years from the grant date. The purchase price of the common stock covered by each option is equal to the fair market value of the stock on the date the option is granted.

The following table summarizes stock option activity for the years 1994-1996:

	1996		1995		1994	
	Options	Weighted-average Exercise Price	Options	Weighted-average Exercise Price	Options	Weighted-average Exercise Price
Balance, January 1	24,248,652	$18.90	22,094,580	$16.52	15,910,240	$15.11
Granted	3,418,020	38.67	5,020,868	26.95	7,497,160	18.67
Exercised	(3,013,606)	14.31	(2,287,940)	13.71	(886,484)	9.39
Forfeited	(742,928)	21.01	(578,856)	18.25	(426,336)	16.61
Balance, December 31,	23,910,138	$22.24	24,248,652	$18.90	22,094,580	$16.52
Options vested, December 31,	11,767,168	$17.65	9,270,504	$15.05	6,875,120	$12.95

The following table summarizes information about stock options outstanding at December 31, 1996.

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	**Number of Options**	**Weighted-average Remaining Contractual Life**	**Weighted-average Exercise Price**	**Number of Options Exercisable**	**Weighted-average Exercise Price**
$ 2.36 - $ 8.63	1,127,226	3.1 yrs.	$ 6.85	1,127,226	$ 6.85
10.14 - 19.97	14,556,434	6.9	18.03	9,352,574	17.66
20.00 - 28.96	4,813,638	8.8	26.91	1,227,368	26.73
30.13 - 39.44	3,412,840	9.8	38.67	60,000	31.56
Total	23,910,138	7.5 yrs.	$22.24	11,767,168	$17.65

Restricted Stock

In 1996, 95,000 shares of restricted stock (122,232 in 1995) were awarded, issued, and placed in escrow under the Stock Compensation Plans and Restricted Stock Plan for Directors; 173,411 shares (144,940 shares in 1995) were released as vesting of participants occurred.

Employee Stock Purchase Plan

The Corporation has an Employee Stock Purchase Plan that allows issuance of up to 36 million shares of common stock to qualified employees at a price equal to 85 percent of the fair market value on the first day of the period in which employees can elect to purchase the stock. In 1996, the Corporation granted each qualified employee, excluding certain officers, the right to purchase in January 1997 up to 773 shares of stock. Under the 1996 offering, 2,348,048 shares were purchased at $27.47 per share, compared with 3,735,600 shares at $16.30 under the 1995 offering. The Board of Directors has approved a 1997 offering under the plan, granting each qualified employee the right to purchase 629 shares at $33.73 per share.

Employee Stock Ownership Plan

The Corporation has an Employee Stock Ownership Plan ("ESOP") for qualified employees. The Corporation 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 cash that is used to purchase such stock. The expense to the Corporation related to the ESOP was $4 million in both 1996 and 1995, and $3 million in 1994.

8. Employee Retirement Benefits

Retirement Savings Plan

All regular employees of the Corporation scheduled to work 1,000 hours or more in a calendar year are eligible to participate in the Corporation's Retirement Savings Plan, which includes a 401(k) option. Employees may contribute up to the lesser of 12 percent of their base salary or the current annual dollar cap established and revised annually by the IRS, with the Corporation matching such contributions up to 3 percent. The Corporation contributed $5 million in 1996, 1995 and 1994.

Postretirement Benefit Plans

All regular employees of the Corporation 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. The Corporation's policy is to contribute an amount no less than the minimum required employee contribution under ERISA. Contributions to the corporate plan reflect benefits attributed to employees' service to date as well as compensation expected to be paid in the future. A $3 million contribution was made to the corporate plan in 1996. Corporate plan assets consist primarily of listed stocks, fixed-income securities, and other liquid assets.

The following table sets forth the corporate retirement plan's funded status and amounts recognized in the Corporation's financial statements at December 31, 1996 and 1995.

	1996	1995
	(Dollars in millions)	
Actuarial present value of benefit obligations:		
Accumulated benefit obligation, including vested benefits of $90 million ($81 million in 1995)	$ (97)	$ (87)
Projected benefit obligation for services rendered to date	$(149)	$(143)
Plan assets at fair value	141	119
Projected benefit obligation in excess of plan assets	(8)	(24)
Unrecognized net (gain) loss from past experience different from that assumed and effects of changes in assumptions	(22)	3
Unrecognized prior service costs	1	1
Unrecognized net transition asset	(9)	(10)
Pension liability included in other liabilities	$ (38)	$ (30)
Net pension cost included the following components:		
Service cost—benefits earned during the period	$ 12	$ 9
Interest cost on projected benefit obligation	11	9
Actual return on plan assets	(22)	(28)
Net amortization and deferral	10	18
Net periodic pension cost	$ 11	$ 8

At December 31, 1996 and 1995, the weighted-average discount rates used in determining the actuarial present value of the projected benefit obligation were 7.75 percent and 7.25 percent, respectively; the average rates of increase in future compensation levels used in the calculation were 5.75 percent in both years, and the expected long-term rates of return on assets were 9.50 percent and 9.25 percent, respectively. The Corporation uses the straight-line method of amortization for prior service costs.

The Corporation also has an Executive Pension Plan and a Supplemental Pension Plan, which supplement for key senior officers the benefits payable under the retirement plan. Estimated benefits

under the supplementary plans are accrued as an expense over the period of employment. Accrued benefits under the Executive Pension Plan generally are funded through a Rabbi trust.

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 benefits if they retire from the Corporation after reaching age 55 with 5 or more years of service. 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 upon length of service with the Corporation. Fannie Mae does not fund this plan.

The following table presents the components of the Corporation's accrued postretirement health care cost liability and net postretirement health care cost as reflected in the financial statements at December 31, 1996 and 1995.

	1996	1995
	(Dollars in millions)	
Accumulated postretirement benefit obligation:		
Retirees	$(19)	$(18)
Other fully eligible participants	(3)	(4)
Other active participants	(19)	(17)
	(41)	(39)
Unrecognized actuarial gain	(12)	(11)
Unrecognized transition obligation	31	33
Accrued postretirement health care cost liability	$(22)	$(17)
Net postretirement health care cost included the following components:		
Service cost—benefits attributed to service during the period	$ 2	$ 2
Interest cost on accumulated postretirement benefit obligation	3	3
Net amortization	2	2
Net postretirement health care cost	$ 7	$ 7

In determining the net postretirement health care cost for 1996, a 6.5 percent annual rate of increase in the per capita cost of covered health care claims was assumed for 1996; the rate was assumed to decrease gradually to 4.5 percent over six years and remain 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, 1996 by $7 million and the aggregate of the service and interest cost components of net postretirement health care cost for the year then ended by $1 million. In determining the net postretirement health care cost for 1995, a 10.0 percent annual rate of increase in the per capita cost of covered health care claim was assumed for 1995; the rate was assumed to decrease gradually to 5.5 percent over eight years and remain at that level thereafter.

The weighted-average discount rates used in determining the accumulated postretirement benefit obligation was 7.75 percent at December 31, 1996 and 7.25 percent at December 31, 1995.

9. Dividends Restrictions

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

Since these restrictions were adopted in 1992, the Corporation has exceeded the applicable capital standards, and, therefore, the Corporation has been making dividend payments without Director approval being required.

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

10. Preferred Stock

The Corporation issued 20,000,000 shares of preferred stock in 1996. The following table presents the preferred stock outstanding as of December 31, 1996.

	Issue Date	Shares issued and outstanding	Stated Value Per Share	Annual Dividend Rate (1)	Redeemable On or After
Series A	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
Total		20,000,000			

(1) The amount of dividends payable on each series of preferred stock is subject to adjustment in the event of a reduction in the dividends received deduction prior to 18 months after the original issuance of such series. The adjustment to the preferred stock dividends will offset the effect of such reduction, to the extent such reduction is not to a deduction level below 50%; no adjustment will be made to the extent any such reductions are to a level below 50%.

Holders of preferred stock are entitled to receive noncumulative, quarterly dividends when and if declared by the Corporation's Board of Directors. Payment of dividends on preferred stock is not mandatory and has priority over payment of dividends on common stock.

11. Financial Instruments with Off-Balance-Sheet Risk

The Corporation is a party to transactions involving financial instruments with off-balance-sheet risk. The Corporation 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 MBS, commitments to purchase mortgages or to issue and guarantee MBS, credit enhancements, and certain hedge instruments. These instruments involve, to varying degrees, elements of credit and market risk in excess of amounts recognized on the balance sheet.

Guaranteed Mortgage-Backed Securities

As issuer and guarantor of MBS, the Corporation is obligated to disburse scheduled monthly installments of principal and interest (at the certificate rate) and the full unpaid principal balance of

any foreclosed mortgage to MBS investors, whether or not any such amounts have been received. The Corporation also is obligated to disburse unscheduled principal payments received from borrowers.

The Corporation's credit risk is mitigated to the extent sellers of pools of mortgages elect to remain at risk on the loans sold to the Corporation or other credit enhancement was 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

The Corporation enters into master delivery commitments with lenders on either a mandatory or 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.

The Corporation also will 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.

Hedge Instruments

The Corporation typically uses short sales of Treasury securities, interest rate swaps, and deferred rate setting agreements to hedge against interest rate movements. The Corporation does not engage in trading or other speculative use of these off-balance-sheet instruments. Changes in the value of these hedge 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 (a) that changes in the value of the item hedged will not substantially offset changes in the value of the hedge instrument, or (b) that the counterparty to the agreement will be unable or unwilling to meet the terms of the agreement.

Short sales of Treasury securities, which are used to hedge interest rate risk on planned debt issuances, are obligations for the delivery of securities on a specified future date at a specified price. Gains and losses that result from the hedge position are deferred and recognized as an adjustment to the debt cost over the life of the hedged debt issuance. Credit risk arises from the possible inability or unwillingness of the counterparty to pay any difference between the agreed-upon price and the current securities price at settlement. This risk is reduced through evaluation of the creditworthiness of counterparties and continuous monitoring of hedge positions. The amount of deferrable unrealized gains on open hedge positions was $2 million at December 31, 1996, compared with $6 million of losses at December 31, 1995. Total deferred gains and losses on closed positions were $203 million and $239 million, respectively, at December 31, 1996, compared with $231 million and $269 million, respectively, at December 31, 1995.

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. The Corporation 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.

The Corporation 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 yield of the specific investments, as presented in the financial statements, include the effects of the swaps.

The Corporation reduces counterparty risk on interest rate swaps by dealing only with experienced swap counterparties with high credit quality, diversifying its swaps across many counterparties and ensuring that swaps generally are executed under master agreements, which provide for netting of certain amounts payable by each party. In addition, counterparties are obligated to post collateral if the Corporation is exposed to credit loss on the related swaps exceeding an agreed-upon threshold. The amount of required collateral is based on credit ratings and the level of credit exposure. The Corporation generally requires overcollateralization from counterparties whose credit ratings have dropped below predetermined levels. Fannie Mae regularly monitors the exposures on its interest rate swaps by marking the positions to market via dealer quotes and internal pricing models. At December 31, 1996, 90 percent of the notional principal amount of Fannie Mae's outstanding interest rate swaps were with counterparties rated A or better (73 percent with counterparties rated AA or better), and 99 percent of the notional principal of outstanding swaps was subject to collateral arrangements. At December 31, 1996, five swap counterparties represented approximately 66 percent of the total notional principal amount of outstanding interest rate swaps. These five counterparties are subject to master collateral agreements.

Deferred rate setting agreements are arrangements under which the Corporation issues debt at a fixed rate and simultaneously enters into an agreement that adjusts the effective rate on that debt based on prevailing market conditions at one or more future dates. At settlement of all or a portion of the deferred rate setting agreements, the Corporation pays or receives cash in an amount representing the present value of the interest rate differential between the fixed rate on the debt and the deferred rate. Counterparty risk is limited to the cash receivable, if any, due under the deferred rate setting agreement. This risk is reduced through evaluating the creditworthiness of counterparties.

Credit Enhancements

The Corporation provides credit enhancement for certain financings involving taxable or tax-exempt bonds, typically issued by state or local government entities for the purpose of providing a source of funding for multifamily projects. In these transactions, Fannie Mae generally pledges an interest in certain mortgages it owns to a trustee for the taxable or tax-exempt bonds, thereby enhancing the credit rating of the state or local government entity's bonds.

Credit Exposure for Off-Balance-Sheet Financial Instruments

The following table presents the contract or notional amount of off-balance-sheet financial instruments at December 31, 1996 and 1995.

	1996	1995
	(Dollars in billions)	
MBS outstanding(1)	$ 650.3	$582.4
MBS in Portfolio	(102.6)	(69.7)
Net MBS outstanding(1)	547.7	512.7
Master commitments:		
Mandatory	24.3	20.4
Optional	37.2	26.9
Portfolio commitments:		
Mandatory	1.9	2.5
Optional	1.2	1.1
MBS commitments:		
Mandatory	1.1	.1
Optional	1.4	3.0
Short sales of Treasury securities	.4	1.0
Interest rate swaps(2)	97.9	74.8
Debt swaps(3)	57.9	48.4
Asset swaps(4)	2.6	2.8
Credit enhancements	3.8	3.1
Other guarantees	4.1	1.8

(1) Net of related allowance for losses. Includes $70.6 billion and $67.1 billion of MBS with lender or third party recourse at December 31, 1996 and 1995, respectively.

(2) The weighted-average interest rate being received under these swaps was 5.61 percent and the weighted-average interest rate being paid was 6.76 percent at December 31, 1996, compared with 5.93 percent and 6.70 percent, respectively, at December 31, 1995.

(3) The weighted-average interest rate being received under these swaps was 5.64 percent and the weighted-average interest rate being paid was 5.47 percent at December 31, 1996, compared with 5.97 percent and 5.76 percent, respectively, at December 31, 1995.

(4) The weighted-average interest rate being received under these swaps was 5.96 percent and the weighted-average interest rate being paid was 6.11 percent at December 31, 1996, compared with 6.15 percent and 6.29 percent, respectively, at December 31, 1995.

Contract or notional amounts do not necessarily represent the market or credit risk of the off-balance-sheet positions. The notional amounts of the instruments are used to calculate contractual cash flows to be exchanged. In addition, any measurement of risk is meaningful only to the extent that offsetting arrangements, such as master netting agreements and the value of related collateral, are included.

The Corporation's exposure to credit loss for off-balance-sheet financial instruments can be estimated by calculating the cost, on a present value basis, to replace at current market rates all those off-balance-sheet financial instruments outstanding for which the Corporation was in a gain position.

The Corporation's net exposure (taking into account master netting agreements) was $10 million at December 31, 1996 and $9 million at December 31, 1995. The Corporation had no pledged collateral at December 31, 1996 and 1995. The Corporation expects the net credit exposure to fluctuate as interest rates change.

12. 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 unpaid principal balances by primary default risk and the general geographic distribution of properties underlying mortgages in the portfolio and MBS outstanding as of December 31, 1996 and 1995.

		Geographic Distribution					
1996	**Gross UPB**	**Northeast**	**Southeast**	**Midwest**	**Southwest**	**West**	**Total**
	(Dollars in millions)						
Fannie Mae risk	$747,394	21%	20%	17%	15%	27%	100%
Lender risk	87,831	20	15	15	12	38	100
Total	$835,225	21%	20%	17%	14%	28%	100%

		Geographic Distribution					
1995	**Gross UPB**	**Northeast**	**Southeast**	**Midwest**	**Southwest**	**West**	**Total**
	(Dollars in millions)						
Fannie Mae risk	$685,461	21%	20%	17%	14%	28%	100%
Lender risk	81,280	22	15	13	12	38	100
Total	$766,741	21%	19%	17%	14%	29%	100%

No significant concentration exists at the state level except for California, where, at December 31, 1996 and 1995, 21 percent of the gross UPB of mortgages in portfolio and backing MBS were located.

To minimize credit risk, the Corporation generally requires primary mortgage insurance or other credit protection if the original loan-to-value ("LTV") ratio of a single-family mortgage loan (unpaid principal amount of the conventional mortgage loan to the value of the mortgaged property at origination of the loan) is greater than 80 percent.

The Corporation currently accepts conventional loans delivered with mortgage insurance from 14 insurance organizations. At December 31, 1996, $221 billion in current UPB of single-family conventional portfolio and MBS outstanding was covered by primary mortgage insurance at acquisition. Five companies, all rated AAA or AA, represented 84 percent of the insurance coverage. The Corporation monitors on a regular basis the performance and financial strength of its mortgage insurers.

The following table presents the LTV ratio distribution by UPB of conventional single-family mortgages in portfolio and backing MBS at December 31, 1996 and 1995.

1996	Gross UPB	Loan-to-Value Ratio(1)						
		60% and Less	61–70%	71–75%	76–80%	81–90%	Over 90%	Total
	(Dollars in millions)							
Fannie Mae risk	$720,503	19%	15%	15%	22%	17%	12%	100%
Lender risk	62,514	14	13	15	27	20	11	100
Total	$783,017	19%	14%	15%	23%	17%	12%	100%

1995	Gross UPB	Loan-to-Value Ratio(1)						
		60% and Less	61–70%	71–75%	76–80%	81–90%	Over 90%	Total
	(Dollars in millions)							
Fannie Mae risk	$660,338	20%	15%	15%	22%	17%	11%	100%
Lender risk	59,615	15	13	15	29	20	8	100
Total	$719,953	20%	15%	15%	22%	17%	11%	100%

(1) Represents original LTV ratios. Current LTV ratios may be higher or lower than the original LTV ratios.

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 interest rate mortgages will prepay at a slower rate. The following table presents the distribution by note rate of fixed-rate single-family loans in the mortgage portfolio and underlying MBS at December 31, 1996 and 1995.

Gross UPB at December 31,	Fixed-Rate Portfolio by Note Rate(1)						
	Under 7.00%	7.00% to 7.99%	8.00% to 8.99%	9.00% to 9.99%	10.00% to 10.99%	11.00% and over	Total
	(Dollars in billions)						
1996	$87	$331	$212	$55	$19	$5	$709
Percent of total	12%	46%	30%	8%	3%	1%	100%
1995	$80	$289	$183	$65	$25	$6	$648
Percent of total	12%	45%	28%	10%	4%	1%	100%

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

13. 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, 1996 and 1995. 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 the Corporation would realize in a market transaction. The accompanying Fair Value Balance Sheets do not represent an estimate of the overall market value of the Corporation as a going concern, which would take into account future business opportunities.

Fair Value Balance Sheets

Assets

	December 31, 1996		December 31, 1995	
	Cost	Fair Value	Cost	Fair Value
	(Dollars in millions)			
Mortgage portfolio, net	$286,259	$290,254	$252,588	$260,430
Investments	56,606	56,624	57,273	57,312
Cash and cash equivalents	850	850	318	318
Other assets	7,326	4,604	6,371	5,249
	351,041	352,332	316,550	323,309
Off-balance-sheet items:				
Guaranty fee income, net	—	3,587	—	2,160
Swap obligations in gain position, net	—	6	—	43
Other	—	8	—	15
Total assets	$351,041	$355,933	$316,550	$325,527

Liabilities and Net Equity

	December 31, 1996		December 31, 1995	
	Cost	Fair Value	Cost	Fair Value
Liabilities				
Noncallable debt:				
Due within one year	$156,854	$156,346	$145,000	$145,313
Due after one year	75,487	72,513	71,731	77,181
Callable debt:				
Due within one year	3,046	3,694	1,153	1,153
Due after one year	95,883	101,822	81,290	82,487
	331,270	334,375	299,174	306,134
Other liabilities	6,998	5,885	6,417	5,024
Off-balance-sheet items:				
Swap obligations in loss position, net	—	1,117	—	3,332
Total liabilities	338,268	341,377	305,591	314,490
Equity, net of tax effect	12,773	14,556	10,959	11,037
Total liabilities and net equity	$351,041	$355,933	$316,550	$325,527

See accompanying Notes to Fair Value Balance Sheets.

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 the Corporation's mortgage portfolio considered such variables as interest rates, credit quality, and loan collateral. Because an active market does not exist for a large 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 interest 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."

The Corporation then employed an option-adjusted spread ("OAS") approach to estimate fair values for both notional MBS (the mortgage loan portfolio) and for MBS held in portfolio. The OAS represents the risk premium or incremental interest spread over Treasury 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 the Corporation'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, approximates their carrying amount. Net currency swap receivables, which are included in other assets at cost, are reclassified as a component of the fair value of the related foreign-denominated debt.

Guaranty Fee Income, Net

MBS are not assets owned by the Corporation, except when acquired for investment purposes, nor are MBS recorded as liabilities of the Corporation. On MBS outstanding, the Corporation receives a guaranty fee calculated on the outstanding principal balance of the related mortgages. The guaranty fee represents a future income stream for the Corporation. 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.

The Corporation estimates the credit loss exposure attached to the notional MBS, MBS held in portfolio, and off-balance-sheet MBS, where Fannie Mae has the primary risk of default. The Corporation deducts estimated credit losses from the projected guaranty fee cash flows to arrive at the fair value. Estimated credit losses are calculated using an internal forecasting model based on actual

historical loss experience for the Corporation. The net guaranty fee cash flows are then valued using an OAS method similar to that described under "Mortgage Portfolio, Net."

Swap Obligations, Net

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

Other Off-Balance-Sheet Items

The Corporation issues mandatory delivery commitments to purchase mortgages or issue MBS. Under mandatory delivery portfolio commitments, lenders are obligated to sell mortgages to the Corporation at the commitment yield. In certain instances, the Corporation enters into MBS sales commitments related to the commitments to purchase mortgages.

Mandatory commitments to purchase mortgages have been valued based on the yield differential between required mortgage yields at the balance sheet date and actual commitment yields, discounted over the estimated life of the assets to be delivered, plus the estimated value of the expected guaranty fee, calculated as described under "Mortgage Portfolio, Net." MBS sales commitments have been valued based on the differential between MBS market prices at the balance sheet date and the prices on MBS sales commitments. Mandatory commitments to issue MBS have been valued based on the expected guaranty fee stream, as described above.

Noncallable and Callable Debt

The fair value of the Corporation's noncallable debt was estimated using quotes for selected benchmark debt securities of the Corporation with similar terms. Similar to the valuation of the mortgage portfolio, the fair value of callable debt was estimated using an OAS model.

Other Liabilities

Other liabilities include accrued interest payable, amounts payable to MBS holders, estimated losses on 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, approximates their carrying amount, except for net currency swap payables, which are included as a component of the fair value of the related foreign-denominated debt, and credit loss exposure for MBS, which is included as a component of the net MBS guaranty fee.

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

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.

	1996 Quarter Ended			
	December	September	June	March
	(Dollars in millions, except per share amounts)			
Interest income	$6,190	$5,993	$5,832	$5,757
Interest expense	5,267	5,093	4,948	4,872
Net interest income	923	900	884	885
Guaranty fees	308	304	296	288
Miscellaneous income, net	28	20	18	20
Provision for losses	(50)	(50)	(50)	(45)
Foreclosed property expenses	(56)	(52)	(53)	(53)
Administrative expenses	(145)	(142)	(138)	(135)
Income before federal income taxes and extraordinary item	1,008	980	957	960
Provision for federal income taxes	(295)	(289)	(282)	(285)
Income before extraordinary item	713	691	675	675
Extraordinary item—early extinguishment of debt (net of tax effect)	—	—	(8)	(21)
Net income	$ 713	$ 691	$ 667	$ 654
Preferred stock dividends	(17)	(12)	(11)	(2)
Net income available to common stockholders	$ 696	$ 679	$ 656	$ 652
Per common share:				
Earnings before extraordinary item	$ .65	$ .63	$ .61	$ .61
Net earnings	.65	.63	.61	.59
Cash dividends	.19	.19	.19	.19

	1995 Quarter Ended			
	December	September	June	March
	(Dollars in millions, except per share amounts)			
Interest income	$5,586	$5,336	$5,162	$4,987
Interest expense	4,746	4,559	4,441	4,278
Net interest income	840	777	721	709
Guaranty fees	280	272	267	267
Miscellaneous income, net	11	23	23	36
Provision for losses	(35)	(35)	(35)	(35)
Foreclosed property expenses	(49)	(46)	(49)	(51)
Administrative expenses	(144)	(138)	(135)	(129)
Special contribution	(350)	—	—	—
Income before federal income taxes and extraordinary item	553	853	792	797
Provision for federal income taxes	(145)	(248)	(214)	(233)
Income before extraordinary item	408	605	578	564
Extraordinary item—early extinguishment of debt (net of tax effect)	—	(8)	(5)	2
Net income	$ 408	$ 597	$ 573	$ 566
Per common share:				
Earnings before extraordinary item(1)	$ .37	$ .55	$ .53	$ .52
Net earnings	.37	.54	.52	.52
Cash dividends	.17	.17	.17	.17

(1) The total of the four quarters does 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 that period.

FANNIE MAE

NET INTEREST INCOME AND AVERAGE BALANCES (Unaudited)

	1996	1995	1994
	(Dollars in millions)		
Interest income:			
Mortgage portfolio	$ 20,560	$ 18,154	$ 15,851
Investments and cash equivalents	3,212	2,917	1,496
Total interest income	23,772	21,071	17,347
Interest expense(1):			
Short-term debt	3,395	3,994	2,315
Long-term debt	16,785	14,030	12,209
Total interest expense	20,180	18,024	14,524
Net interest income	3,592	3,047	2,823
Tax equivalent adjustment(2)	247	211	134
Net interest income tax equivalent basis	$ 3,839	$ 3,258	$ 2,957
Average balances:			
Interest-earning assets(3):			
Mortgage portfolio, net	$268,629	$232,558	$205,998
Investments and cash equivalents	57,161	48,143	32,431
Total interest-earning assets	$325,790	$280,701	$238,429
Interest-bearing liabilities(1):			
Short-term debt	$ 63,974	$ 67,886	$ 53,856
Long-term debt	246,733	199,497	170,911
Total interest-bearing liabilities	310,707	267,383	224,767
Interest-free funds	15,083	13,318	13,662
Total interest-bearing liabilities and interest-free funds	$325,790	$280,701	$238,429
Average interest rates(2):			
Interest-earning assets:			
Mortgage portfolio, net	7.71%	7.85%	7.71%
Investments and cash equivalents	5.68	6.15	4.70
Total interest-earning assets	7.36	7.56	7.30
Interest-bearing liabilities(1)			
Short-term debt	5.22	5.85	4.35
Long-term debt	6.82	7.06	7.14
Total interest-bearing liabilities	6.49	6.75	6.47
Investment spread(4)	.87	.81	.83
Interest-free return(5)	.31	.35	.41
Net interest margin(6)	1.18%	1.16%	1.24%

(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 interest rate swaps.

(2) Reflects pro forma adjustments to permit comparison of yields on tax-advantaged and taxable assets.

(3) Includes average balance of nonperforming loans of $2.2 billion, $2.0 billion, and $1.6 billion in 1996, 1995, and 1994, respectively.

(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 tax equivalent basis, as a percentage of the average investment portfolio.

FANNIE MAE

RATE / VOLUME ANALYSIS (Unaudited)

	Increase (Decrease)	Attributable to changes in (1)	
		Volume	Rate
	(Dollars in millions)		
1996 vs. 1995			
Interest income:			
Mortgage portfolio	$2,406	$2,767	$(361)
Investments and cash equivalents	295	518	(223)
Total interest income	2,701	3,285	(584)
Interest expense(2):			
Short-term debt	(599)	(222)	(377)
Long-term debt	2,755	3,227	(472)
Total interest expense	2,156	3,005	(849)
Net interest income	$ 545	$ 280	$ 265
1995 vs. 1994			
Interest income:			
Mortgage portfolio	$2,303	$2,070	$ 233
Investments and cash equivalents	1,421	863	558
Total interest income	3,724	2,933	791
Interest expense(2):			
Short-term debt	1,679	695	984
Long-term debt	1,821	2,013	(192)
Total interest expense	3,500	2,708	792
Net interest income	$ 224	$ 225	$ (1)

(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 interest rate swaps.

MANAGEMENT

Directors

The age and background, as of March 24, 1997, of each of the members of the Board of Directors of the Corporation are as follows:

Name and Age	Principal Occupation, Business Experience, and Residence	First Became Director	Other Directorships(1)
Stephen B. Ashley, 57	Chairman and Chief Executive Officer, The Ashley Group, a group of commercial and multi-family real estate, brokerage and investment companies, January 1997 to present; Chairman and Chief Executive Officer, Sibley Mortgage Corporation, a mortgage banking company, 1985 to 1996; Chairman and Chief Executive Officer, Sibley Real Estate Services, Inc., a property management company, 1985 to 1996; Livonia, New York	1995	The Genesee Corporation; Hahn Automotive Warehouse, Inc.; Manning & Napiers Advisors, Inc.
Roger E. Birk, 66	President and Chief Operating Officer of the Corporation, November 1987 until his retirement in January 1992; Tequesta, Florida	1985	Golden Bear Golf; Mutual of America Capital Corp.; Penske Transportation; WellPoint Health Networks Inc.
Stephen Friedman, 59	Senior Chairman and Limited Partner, December 1994 to present, Co-Chairman or sole Chairman, December 1990 to November 1994, Goldman, Sachs & Co., an investment banking firm; New York, NY	1996	Wal-Mart Stores, Inc.
Thomas P. Gerrity, 55	Dean of The Wharton School of the University of Pennsylvania, an educational institution, July 1990 to present; President of CSC Consulting, a subsidiary of Computer Sciences Corporation, and Vice President of Computer Sciences Corporation, May 1989 to June 1990; Chairman and Chief Executive Officer, Index Group, a technology-oriented consulting company, 1969 to April 1989; Haverford, Pennsylvania	1991	CVS Corporation; Digital Equipment Corporation; Reliance Group Holdings, Inc.; Sun Company, Inc.; Union Carbide Corporation
James A. Johnson, 53	Chairman of the Board of Directors and Chief Executive Officer of the Corporation, February 1991 to present; Vice Chairman of the Board of the Corporation, January 1990 to January 1991; Managing Director, Shearson Lehman Brothers, Inc., an investment banking firm, April 1985 to December 1989; Washington, D.C.	1990	Dayton Hudson Corporation; Kaufman and Broad Home Corporation; United HealthCare Corporation
Thomas A. Leonard(2), 50	Partner, Obermayer, Rebmann, Maxwell & Hippel, a law firm, January 1992 to present; Philadelphia, Pennsylvania	1993	
Vincent A. Mai, 56	President and Chief Executive Officer, AEA Investors Inc., a private investment company, April 1989 to present; Managing Director, Shearson Lehman Brothers, Inc., an investment banking firm, 1974 to April 1989; Port Washington, New York	1991	
Ann McLaughlin, 55	Chairman, October 1996 to present, Vice Chairman, August 1993 to September 1996, The Aspen Institute, a nonprofit organization; President, Federal City Council, May 1990 to September 1995; President and Chief Executive Officer, New American Schools Development Corporation, June 1992 to April 1993; Visiting Fellow, Urban Institute, January 1989 to June 1992; Chairman, President's Commission on Aviation Security and Terrorism, September 1989 to May 1990; U.S. Secretary of Labor, December 1987 to December 1989; Washington, D.C.	1994	AMR Corporation (and its subsidiary, American Airlines); Donna Karan International Inc.; General Motors Corporation; Harman International Industries, Inc.; Host Marriott Corporation; Kellogg Company; Nordstrom Inc.; Potomac Electric Power Company; Sedgwick Group, plc; Union Camp Corporation; Vulcan Materials Company

Name and Age	Principal Occupation, Business Experience, and Residence	First Became Director	Other Directorships (1)
Richard D. Parsons, 48	President, Time Warner Inc., a media and entertainment corporation, January 1995 to present; Chairman of the Board and Chief Executive Officer, January 1991 to January 1995, President and Chief Executive Officer, July 1990 to January 1991, and President and Chief Operating Officer, July 1988 to June 1990, The Dime Savings Bank of New York, FSB, a financial institution; Pocantico Hills, New York	1989	Citicorp; Philip Morris Companies, Inc.; Time Warner Inc.
Joe K. Pickett, 51	Chairman and Chief Executive Officer, HomeSide Lending, Inc. (successor entity to BancBoston Mortgage Corporation), a mortgage banking company, April 1990 to present; Jacksonville, Florida	1996	Dal-Tile International Inc.
John R. Sasso (2), 49	Vice President, Chief Administrative Officer, Fisher Scientific International Inc., a provider of scientific equipment, July 1996 to present; President, Advanced Strategies, Inc., a corporate communications and public affairs consulting firm, January 1990 to June 1996; Wayland, Massachusetts	1993	
Antonia Shusta, 47	Chief Executive Officer of Consumer Businesses, Pacific Financial Group, a group of financial services companies, since January 1997; Group Executive, Household International, a financial services company, April 1988 to February 1995; Chairman, President and Chief Executive Officer, Household Bank, F.S.B., a wholly-owned subsidiary of Household International, 1990 to January 1995; Key Biscayne, Florida	1994	
Lawrence M. Small, 55	President and Chief Operating Officer of the Corporation, February 1992 to present; President and Chief Operating Officer-Designate of the Corporation, September 1991 to January 1992; Vice Chairman and Chairman of the Executive Committee, January 1990 to July 1991, Sector Executive, January 1985 to December 1989, Citicorp/Citibank, a financial institution; Washington, D.C.	1991	The Chubb Corporation; Marriott International, Inc.
Kathryn G. Thompson (2), 56	Chairman and Chief Executive Officer, Kathryn G. Thompson Construction Company, a building and development company, 1967 to present; Dana Point, California	1995	
José H. Villarreal (2), 43	Partner, Akin, Gump, Strauss, Hauer & Feld, L.L.P., a law firm, August 1994 to present; Partner, McGinnis, Lochridge & Kilgore, L.L.P., a law firm, July 1993 to August 1994; Associate Director, White House Office of Presidential Personnel, April 1993 to June 1993; Presidential Transition Team, November 1992 to March 1993; Deputy Campaign Manager, Clinton Campaign, June 1992 to November 1992; Associate, McGinnis, Lochridge & Kilgore, February 1991 to May 1992; San Antonio, Texas	1993	

Name and Age	Principal Occupation, Business Experience, and Residence	First Became Director	Other Directorships (1)
Karen Hastie Williams, 52	Partner, Crowell & Moring, a law firm practicing in the District of Columbia, 1982 to present; Washington, D.C.	1988	Continental Airlines, Inc.; Crestar Financial Corporation; SunAmerica Inc.; Washington Gas Company

(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 are also noted in the occupation column.

(2) Appointed by the President of the United States, who has authority to appoint five directors. The President currently has appointed four directors and may appoint one additional director.

The term of each director will end on the date of the May 1997 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 24, 1997, of each of the executive officers of the Corporation, are as follows:

James A. Johnson, 53, has been Chairman of the Board of Directors and Chief Executive Officer since February 1991. Mr. Johnson was Vice Chairman of the Board of Directors from January 1990 to January 1991. Mr. Johnson was a Managing Director in Corporate Finance at Shearson Lehman Brothers, Inc. from April 1985 to December 1989.

Lawrence M. Small, 55, has been President and Chief Operating Officer since February 1992. Mr. Small was President and Chief Operating Officer-Designate of the Corporation from September 1991 to January 1992. Prior to his employment with the Corporation, Mr. Small was with Citicorp/Citibank, where he was Vice Chairman and Chairman of the Executive Committee from January 1990 to July 1991.

J. Timothy Howard, 48, has been Executive Vice President and Chief Financial Officer since February 1990.

William E. Kelvie, 49, has been Executive Vice President and Chief Information Officer since November 1992. Mr. Kelvie was Senior Vice President and Chief Information Officer from November 1990 to November 1992.

Robert J. Levin, 41, has been Executive Vice President—Marketing since June 1990.

Ann D. Logan, 42, has been Executive Vice President and Chief Credit Officer since May 1993. Ms. Logan has been an Executive Vice President since January 1993 and was Senior Vice President—Northeastern Regional Office from June 1989 to January 1993.

Robert B. Zoellick, 43, has been Executive Vice President—Housing and Law since November 1996. Mr. Zoellick was Executive Vice President, General Counsel, and Secretary of the Corporation from July 1993 to November 1996 and Executive Vice President, General Counsel, and Corporate Secretary-Designate from May 1993 until June 1993. He was Assistant to the President and Deputy Chief of Staff of the White House from August 1992 to January 1993. From March 1991 to August 1992 he also served as Under Secretary of State for Economics and Agricultural Affairs.

Glenn T. Austin, Jr., 48, has been Senior Vice President—Southeastern Regional Office since May 1985.

Kenneth J. Bacon, 42, has been Senior Vice President—Northeastern Regional Office since April 1993. Mr. Bacon was Director of the Office of Securitization at the Resolution Trust Corporation ("RTC") from February 1991 to April 1993.

Douglas M. Bibby, 50, has been Senior Vice President—Human Resources since November 1995. Mr. Bibby was Senior Vice President—Administration from October 1988 to November 1995.

John Buckley, 40, has been Senior Vice President—Communications since November 1991.

Donna Callejon, 34, has been Senior Vice President—Corporate Development since July 1996. Ms. Callejon was Senior Vice President—Single-Family Marketing from November 1991 to July 1996.

William G. Ehrhorn, 48, has been Senior Vice President—Mortgage Operations since May 1993. Mr. Ehrhorn is a former executive vice president and division manager for operations, automation management, securities lending, and the Trust Company with Nomura Securities International, which he joined in May 1985. Mr. Ehrhorn also was a member of the firm's management committee.

John R. Hayes, 58, has been Senior Vice President—Midwestern Regional Office since November 1985.

Lynda C. Horvath, 44, has been Senior Vice President—Capital Markets since July 1996. Ms. Horvath was Senior Vice President—Corporate Development from May 1993 to July 1996. Ms. Horvath was Senior Vice President—Mortgage Operations from February 1991 to May 1993.

Louis W. Hoyes, 48, has been Senior Vice President—Multifamily Lending and Investment since July 1995. Prior to his employment with the Corporation, Mr. Hoyes was Managing Director of the residential segment of Citicorp's Real Estate business in North America, where he held a number of other positions after joining Citicorp/Citibank in 1973.

Anastasia D. Kelly, 47, has been Senior Vice President and General Counsel since November 1996. She was Senior Vice President and Deputy General Counsel from April 1995 to November 1996. Prior to her employment with the Corporation, Ms. Kelly was a partner in the law firm of Wilmer, Cutler & Pickering in Washington, D.C., which she joined in 1985.

Linda K. Knight, 47, has been Senior Vice President and Treasurer since February 1993. Ms. Knight was Vice President and Assistant Treasurer from November 1986 to February 1993.

Thomas A. Lawler, 44, has been Senior Vice President—Portfolio Management since November 1989.

Thomas A. Lund, 38, has been Senior Vice President—Southwestern Regional Office since July 1996. Mr. Lund was Vice President—Marketing in the Southwestern Regional Office from January 1995 to July 1996. Prior to his employment with the Corporation, Mr. Lund was Senior Vice President and General Manager for Negotiated Transactions for the GE Capital Mortgage Corporation from 1990 to 1994.

William R. Maloni, 52, has been Senior Vice President—Government and Industry Relations since November 1995. Mr. Maloni was Senior Vice President—Policy and Public Affairs from March 1989 to November 1995.

Adolfo Marzol, 36, has been Senior Vice President—Single-Family Business Management since July 1996. Mr. Marzol was Senior Vice President—Capital Markets from February 1996 to July 1996. Mr. Marzol was Executive Vice President and Chief Financial Officer of Chase Manhattan Mortgage Corporation, a mortgage company, from July 1993 to January 1996 and Senior Vice President—Interest Rate Risk of that firm from February 1991 to June 1993.

Michael A. Quinn, 42, has been Senior Vice President—Credit Loss Management since April 1994. Mr. Quinn was Senior Vice President and Controller from March 1991 to April 1994.

Sampath Rajappa, 51, has been Senior Vice President and Controller since April 1994. Mr. Rajappa joined the Corporation in March 1994 as Corporate Controller. Prior thereto, Mr. Rajappa was Senior Vice President and Controller for ITT Residential Capital Corporation, a mortgage banking company, from August 1993 to February 1994; Chief Financial Officer of ITT Consumer Financial Corporation, a financial services company, from September 1992 to August 1993.

Jayne J. Shontell, 42, has been Senior Vice President—Investor Relations since February 1996. Ms. Shontell was Senior Vice President—Financial and Information Services from November 1992 to February 1996, Vice President for Financial Services and Information Group from August 1992 to November 1992, Vice President for Business Development from September 1991 to August 1992.

Elizabeth A. Snyder, 43, has been Senior Vice President—Western Regional Office since February 1996. Ms. Snyder was Senior Vice President—Investor Relations from April 1994 to February 1996, Vice President and Assistant to the Chairman of the Corporation from July 1992 to April 1994, Vice President for Regulatory Policy from January 1992 to July 1992.

Michael Williams, 39, has been Senior Vice President—Customer Technology Services since February 1996. Mr. Williams was Senior Vice President—Customer Applications and Technology Integration from November 1993 to January 1996, Vice President—Customer Applications and Technology Integration from November 1992 to November 1993, Vice President—Risk Management Systems from September 1991 to November 1992 and Vice President—Data Resources Management from March 1991 to September 1991.

Barry Zigas, 45, has been Senior Vice President and Executive Director—National Housing Impact Division since February 1996. Mr. Zigas was Senior Vice President—Housing Impact Policy from November 1995 to January 1996, and Vice President—Housing Impact from June 1993 to October 1995.

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 the Corporation, reference is made to the Corporation's proxy statement, dated March 25, 1996 for the Corporation's 1996 annual meeting of stockholders and any later proxy statement published prior to the Corporation's publication of a new Information Statement, which are incorporated herein by this reference. The proxy statement for the Corporation's 1997 annual meeting of stockholders will be available in April 1997.

The Corporation will provide without charge a copy of the Corporation'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.

ACCOUNTANTS

The financial statements of the Corporation as of December 31, 1996 and 1995 and for each of the years in the three-year period ended December 31, 1996, included herein, have been included in reliance upon the report of KPMG Peat Marwick LLP, independent certified public accountants, and upon the authority of that firm as experts in accounting and auditing.

FannieMae