

**Supplement dated November 14, 1995 to
Information Statement dated March 31, 1995**

Federal National Mortgage Association



This Supplement describes the financial condition of the Federal National Mortgage Association ("Fannie Mae" or the "Corporation") as of September 30, 1995 and contains unaudited financial statements with respect to the Corporation for the quarter and nine months ended September 30, 1995. This Supplement should be read in conjunction with the Corporation's Information Statement dated March 31, 1995 (the "Information Statement"), and the Supplements dated May 12, 1995 and August 14, 1995 thereto (the "Supplements"), which are hereby incorporated by reference. The Information Statement describes the business and operations of the Corporation and contains financial data as of December 31, 1994. The May 12, 1995 and August 14, 1995 Supplements describe the financial condition of the Corporation as of March 31, 1995 and June 30, 1995, respectively, and contain unaudited financial statements with respect to the Corporation for the quarters and year-to-date periods then ended. In addition, the Supplements discuss certain other developments that may affect the Corporation. Fannie Mae also periodically makes available statistical information on its mortgage purchase and mortgage-backed securities volumes as well as other relevant information about Fannie Mae. Copies of the Corporation's current Information Statement, any supplements thereto and other available information can be obtained without charge from the Office of Investor Relations, Fannie Mae, 3900 Wisconsin Avenue, N.W., Washington, D.C. 20016 (telephone: 202/752-7115).

In conjunction with its securities offerings, the Corporation may incorporate this Supplement by reference in one or more other documents describing the securities offered thereby, the selling arrangements therefor, and other relevant information. Such other documents may be called an Offering Circular, Prospectus, Guide to Debt Securities or otherwise. This Supplement does not itself constitute an offer or a solicitation of an offer to purchase such securities.

Fannie Mae is a federally chartered corporation. Its principal office is located at 3900 Wisconsin Avenue, N.W., Washington, D.C. 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 October 31, 1995, approximately 272,800,000 shares of the Corporation's common stock (without par value) were outstanding.

The delivery of this Supplement 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.

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SELECTED FINANCIAL DATA

The following selected financial data for the three-month and nine-month periods ended September 30, 1995 and 1994 are unaudited and include, in the opinion of management, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation. Operating results for the periods ended September 30, 1995 are not necessarily indicative of the results expected for the entire year.

(Dollars in millions, except per share amounts)

| | <u>Three Months Ended</u> <u>September 30,</u> | | <u>Nine Months Ended</u> <u>September 30,</u> | |
|---|---|---------------|--|-----------------|
| | <u>1995</u> | <u>1994</u> | <u>1995</u> | <u>1994</u> |
| Income Statement Data: | | | | |
| Interest income | \$ 5,336 | \$ 4,435 | \$15,485 | \$ 12,604 |
| Interest expense | 4,559 | 3,707 | 13,278 | 10,492 |
| Net interest income | 777 | 728 | 2,207 | 2,112 |
| Guaranty fees | 272 | 272 | 806 | 814 |
| Gain (loss) on sales of mortgages, net | — | — | 3 | (2) |
| Miscellaneous income, net | 23 | 28 | 79 | 119 |
| Provision for losses | (35) | (40) | (105) | (120) |
| Foreclosed property expenses | (46) | (53) | (146) | (171) |
| Administrative expenses | (138) | (132) | (402) | (386) |
| Income before federal income taxes and extraordinary item | 853 | 803 | 2,442 | 2,366 |
| Provision for federal income taxes | (248) | (260) | (695) | (770) |
| Income before extraordinary item | 605 | 543 | 1,747 | 1,596 |
| Extraordinary loss—early extinguishment of debt, net of tax effect | (8) | — | (11) | (17) |
| Net income | <u>\$ 597</u> | <u>\$ 543</u> | <u>\$ 1,736</u> | <u>\$ 1,579</u> |
| Per share: | | | | |
| Earnings before extraordinary item | \$ 2.20 | \$ 1.98 | \$ 6.35 | \$ 5.81 |
| Net earnings | 2.17 | 1.98 | 6.31 | 5.75 |
| Cash dividends | 0.68 | 0.60 | 2.04 | 1.80 |
| <u>September 30,</u> | | | | |
| Balance Sheet Data: | | | | |
| Mortgage portfolio, net | \$240,218 | \$214,003 | | |
| Investments | 47,716 | 34,492 | | |
| Total assets | 294,230 | 254,805 | | |
| Borrowings: | | | | |
| Due within one year | 127,659 | 96,350 | | |
| Due after one year | 149,534 | 142,970 | | |
| Total liabilities | 283,507 | 245,619 | | |
| Stockholders' equity | 10,723 | 9,186 | | |
| <u>Three Months Ended</u> <u>September 30,</u> | | | | |
| Other Data: | | | | |
| Net interest margin | 1.17% | 1.25% | 1.15% | 1.27% |
| Return on average equity | 22.8 | 24.2 | 23.0 | 24.5 |
| Return on average assets | 0.8 | 0.9 | 0.8 | 0.9 |
| Ratio of earnings to fixed charges(1) | 1.18:1 | 1.22:1 | 1.18:1 | 1.22:1 |
| Dividend payout ratio | 31.1% | 30.2% | 32.1% | 31.2% |
| Equity to assets ratio | 3.6 | 3.6 | 3.6 | 3.6 |
| Mortgage purchases | \$ 16,347 | \$ 12,971 | \$36,764 | \$ 50,438 |
| MBS issued | 34,421 | 24,637 | 68,821 | 111,037 |
| MBS outstanding at period end | 559,585 | 523,512 | | |
| Capital at period end(2) | 11,537 | 10,012 | | |

(1) For the purpose of calculating the ratio of earnings to fixed charges, "earnings" consists of income before federal taxes and fixed charges. "Fixed charges" represents interest expense.

(2) Stockholders' equity plus allowance for losses.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS FOR THE THREE-MONTH AND
NINE-MONTH PERIODS ENDED SEPTEMBER 30, 1995**

Results of Operations

In the third quarter of 1995, Fannie Mae again reported record earnings as net income increased \$54 million to \$597 million or 10 percent over the results for the third quarter of 1994. For the first nine months of 1995, net income increased \$157 million or 10 percent to \$1.736 billion compared with \$1.579 billion for the first nine months of 1994. The growth in net income for the three-month and nine-month periods ended September 30, 1995 was attributable mainly to increases in business volume and net interest income combined with lower credit-related expenses and federal income tax expense.

Net interest income in the third quarter of 1995 increased 7 percent, 9 percent on a tax equivalent basis, compared with the third quarter of 1994, primarily due to 17 percent growth in the average net investment balance, which was partially offset by an 8 basis point decrease in the net interest margin. Net interest income in the first nine months of 1995 increased 4 percent, 7 percent on a tax equivalent basis, compared with the first nine months of 1994, as a result of 18 percent growth in the average net investment balance, which was partially offset by a 12 basis point decrease in the net interest margin. The decline in net interest margin was primarily due to a lengthening of debt and higher short-term borrowing costs. Management believes that the net interest margin will be favorably affected and net interest income will continue to expand in the fourth quarter of 1995 due to portfolio growth at attractive spreads, positive long-term debt rollover, and favorable short-term debt repricings.

The following table presents an analysis of net interest income for the three-month and nine-month periods ended September 30, 1995 and 1994.

**Net Interest Income and Average Balances
(Dollars in millions)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|------------------|------------------------------------|------------------|
| | 1995 | 1994 | 1995 | 1994 |
| Interest income: | | | | |
| Mortgage portfolio | \$ 4,603 | \$ 4,038 | \$ 13,364 | \$ 11,636 |
| Investments and cash equivalents | 733 | 397 | 2,121 | 968 |
| Total interest income | <u>5,336</u> | <u>4,435</u> | <u>15,485</u> | <u>12,604</u> |
| Interest expense(1): | | | | |
| Short-term debt | 1,037 | 612 | 2,980 | 1,554 |
| Long-term debt | 3,522 | 3,095 | 10,298 | 8,938 |
| Total interest expense | <u>4,559</u> | <u>3,707</u> | <u>13,278</u> | <u>10,492</u> |
| Net interest income | 777 | 728 | 2,207 | 2,112 |
| Tax equivalent adjustment(2) | 52 | 33 | 154 | 94 |
| Net interest income tax equivalent basis | <u>\$ 829</u> | <u>\$ 761</u> | <u>\$ 2,361</u> | <u>\$ 2,206</u> |
| Average balances: | | | | |
| Interest-earning assets(3): | | | | |
| Mortgage portfolio, net | \$235,618 | \$210,311 | \$227,774 | \$202,126 |
| Investments and cash equivalents | 48,470 | 32,906 | 46,225 | 30,225 |
| Total interest-earning assets | <u>\$284,088</u> | <u>\$243,217</u> | <u>\$273,999</u> | <u>\$232,351</u> |
| Interest-bearing liabilities(1): | | | | |
| Short-term debt | \$ 69,353 | \$ 55,766 | \$ 67,038 | \$ 51,781 |
| Long-term debt | 201,572 | 174,609 | 194,040 | 166,593 |
| Total interest-bearing liabilities | 270,925 | 230,375 | 261,078 | 218,374 |
| Interest-free funds | 13,163 | 12,842 | 12,921 | 13,977 |
| Total interest-bearing liabilities and interest-free funds | <u>\$284,088</u> | <u>\$243,217</u> | <u>\$273,999</u> | <u>\$232,351</u> |
| Average interest rates(2): | | | | |
| Interest-earning assets: | | | | |
| Mortgage portfolio, net | 7.86% | 7.69% | 7.86% | 7.69% |
| Investments and cash equivalents | 6.13 | 4.88 | 6.21 | 4.34 |
| Total interest-earning assets | <u>7.57</u> | <u>7.31</u> | <u>7.58</u> | <u>7.26</u> |
| Interest-bearing liabilities(1): | | | | |
| Short-term debt | 5.82 | 4.49 | 5.93 | 3.99 |
| Long-term debt | 7.03 | 7.09 | 7.09 | 7.15 |
| Total interest-bearing liabilities | <u>6.72</u> | <u>6.46</u> | <u>6.79</u> | <u>6.41</u> |
| Investment spread | .85 | .85 | .79 | .85 |
| Miscellaneous(4) | .32 | .40 | .36 | .42 |
| Net interest margin | <u>1.17%</u> | <u>1.25%</u> | <u>1.15%</u> | <u>1.27%</u> |

- (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 \$1.9 billion for the three- and nine-month periods ended September 30, 1995 and \$1.8 billion and \$1.5 billion, respectively, for the three- and nine-month periods ended September 30, 1994.
- (4) Consists primarily of the return on that portion of the investment portfolio funded by equity and non-interest-bearing liabilities.

The following rate/volume analysis shows the relative contribution of asset and debt growth and interest rate changes to changes in net interest income for the three-month and nine-month periods ended September 30, 1995 and 1994.

Rate / Volume Analysis

(Dollars in millions)

| | Third Quarter 1995 vs. Third Quarter 1994 | | | First Nine Months 1995 vs. First Nine Months 1994 | | |
|--|--|-----------------------------------|---------------|--|-----------------------------------|---------------|
| | Increase (Decrease) | Attributable to Changes in (1) | | Increase (Decrease) | Attributable to Changes in (1) | |
| | | Volume | Rate | | Volume | Rate |
| Interest income: | | | | | | |
| Mortgage portfolio | \$565 | \$493 | \$ 72 | \$1,728 | \$1,501 | \$227 |
| Investments and cash equivalents | 336 | 219 | 117 | 1,153 | 634 | 519 |
| Total interest income | <u>901</u> | <u>712</u> | <u>189</u> | <u>2,881</u> | <u>2,135</u> | <u>746</u> |
| Interest expense: | | | | | | |
| Short-term debt | 425 | 171 | 254 | 1,426 | 541 | 885 |
| Long-term debt | 427 | 472 | (45) | 1,360 | 1,458 | (98) |
| Total interest expense | <u>852</u> | <u>643</u> | <u>209</u> | <u>2,786</u> | <u>1,999</u> | <u>787</u> |
| Net interest income | <u>\$ 49</u> | <u>\$ 69</u> | <u>\$(20)</u> | <u>\$ 95</u> | <u>\$ 136</u> | <u>\$(41)</u> |

(1) Combined rate/volume variances, a third element of the calculation, are allocated to the rate and volume variances based on their relative size.

Guaranty fee income in the third quarter of 1995 was \$272 million, unchanged from the third quarter of 1994. A 2 percent increase in average net MBS outstanding in the third quarter 1995 over the third quarter 1994 was offset by a decrease in the average guaranty fee rate to 22.0 basis points in the third quarter of 1995 from 22.5 basis points in the third quarter of 1994. For the first nine months of 1995, guaranty fee income decreased by \$8 million as a 2 percent increase in average net MBS outstanding to \$490.0 billion was offset by a reduction in the average guaranty fee rate to 21.9 basis points in the first nine months of 1995 from 22.6 basis points in the comparable period in 1994. Guaranty fees and growth in net MBS outstanding were constrained by a reduction in loan securitization, in the early part of 1995, and by an increase in MBS held in portfolio. Guaranty fees on MBS held in portfolio are included in interest income.

In the third quarter of 1995, miscellaneous income decreased by 18 percent to \$23 million versus \$28 million in the third quarter of 1994. For the first nine months of 1995, miscellaneous income declined by 34 percent to \$79 million versus \$119 million in the first nine months of 1994. The decline in miscellaneous income for the third quarter of 1995 versus the third quarter of 1994 was primarily the result of \$10 million of net operating losses on affordable housing project investments. Effective January 1, 1995, the Corporation changed to the equity method of accounting for these investments. Previously, the Corporation used the cost recovery method. The decline in miscellaneous income for the first nine months of 1995 versus the first nine months of 1994 was primarily a result of lower REMIC fees and other miscellaneous fees, and net operating losses on affordable housing investments. Net REMIC fees were \$9 million for the third quarter of 1995 compared with \$14 million for the third quarter of 1994, and \$49 million for the first nine months of 1995 compared with \$68 million in the first nine months of 1994. In the first nine months of 1995, the Corporation recognized additional deferred REMIC fees due to lower expected REMIC processing costs; however, REMIC fees were lower overall, primarily because of a decline in the volume of REMIC issuances. The Corporation believes miscellaneous income in the fourth quarter of 1995 will be somewhat lower than the quarterly amounts recorded in the earlier part of the year due to a continued reduction in REMIC fees combined with lower other miscellaneous fees.

Administrative expenses for the quarter ended September 30, 1995 were \$138 million, compared with \$132 million during the same period in 1994. For the nine months ended September 30, 1995, administrative expenses were \$402 million, compared with \$386 million for the same period in 1994. Compensation expense, the largest component of administrative expenses, was \$78 million in the third quarter of 1995, compared with \$74 million in the third quarter of 1994. For the first nine months of 1995, compensation expense was \$233 million, compared with \$217 million in the first nine months of 1994. The ratio of administrative expenses to the average mortgage portfolio plus average MBS outstanding was .075 percent (annualized) for the three months and nine months ended September 30, 1995 compared with .076 percent (annualized) for the three months and .075 percent (annualized) for the nine months ended September 30, 1994. The ratio of administrative expenses to revenues (net interest income, guaranty fees, and miscellaneous income) was 12.8 percent for the third quarter of 1995 and 1994, and was 13.0 percent for the first nine months of 1995, compared with 12.7 percent for the first nine months of 1994. Management believes that the growth in administrative expense in 1995 will not be significantly different from the growth rate for the first nine months of 1995 versus the same period in 1994.

The effective federal income tax rate was 29 percent for the third quarter of 1995 and 28 percent for the first nine months of 1995, compared with 32 percent for the three- and nine-month periods ended September 30, 1994. The reduction in the effective tax rate for the third quarter and first nine months of 1995 resulted primarily from the settlement of several items relating to the 1986 and 1987 tax years and from recognition of additional tax benefits related to the change in accounting for affordable housing project investments.

In the third quarter of 1995, the Corporation had an extraordinary loss of \$12 million (\$8 million after tax) from the repurchase or call of debt. There were no losses from the call or repurchase of debt in the third quarter of 1994. An extraordinary loss of \$17 million (\$11 million after tax) was reported in the first nine months of 1995 from the repurchase or call of debt, compared with a loss of \$24 million (\$17 million after tax) from repurchases or calls in the first nine months of 1994. The repurchase or call of high-coupon debt favorably affects the Corporation's cost of funds in future periods.

Net Income by Line of Business

Management views itself as being in three separate businesses: Portfolio Investment, Credit Guaranty and Fee-based Services. The Portfolio Investment business includes the management of asset purchase and funding activities for the Corporation's mortgage and investment portfolios. Income is primarily derived from the difference, or spread, between the yield on mortgage loans and investments and the borrowing costs related to these investments. The Portfolio Investment business represented \$278 billion, or 94 percent, of total assets at September 30, 1995 and \$242 billion, or 95 percent, of total assets at September 30, 1994. The Credit Guaranty business involves guaranteeing the credit performance of both single-family and multifamily loans for a fee. Net interest income for the Credit Guaranty business also includes income from the temporary investment of principal and interest payments on guaranteed mortgages prior to remittance to investors. The Fee-based Services business provides a supplemental source of income for the Corporation through offering various services to lenders and others for a fee. These services include the issuance of REMICs, Stripped MBS, and Fannie Megs, technology services for originating and underwriting loans, and facilitating securities transactions.

The following tables set forth the Corporation's financial information by line of business for the three months and nine months ended September 30, 1995 and 1994. Significant changes from period to period were due to the same factors discussed under "Results of Operations."

| <u>Three Months Ended September 30,</u> | <u>1995</u> | | | | <u>1994</u> | | | |
|---|-----------------------------|------------------------|---------------------------|---------------|-----------------------------|------------------------|---------------------------|---------------|
| | <u>Portfolio Investment</u> | <u>Credit Guaranty</u> | <u>Fee-based Services</u> | <u>Total</u> | <u>Portfolio Investment</u> | <u>Credit Guaranty</u> | <u>Fee-based Services</u> | <u>Total</u> |
| | (Dollars in millions) | | | | | | | |
| Net interest income..... | \$ 668 | \$ 101 | \$ 8 | \$ 777 | \$ 638 | \$ 83 | \$ 7 | \$ 728 |
| Guaranty fees | (158) | 430 | — | 272 | (146) | 418 | — | 272 |
| Miscellaneous, net | 8 | (1) | 16 | 23 | 5 | 4 | 19 | 28 |
| Provision for losses | — | (35) | — | (35) | — | (40) | — | (40) |
| Foreclosed property expenses | — | (46) | — | (46) | — | (53) | — | (53) |
| Administrative expenses | (34) | (89) | (15) | (138) | (26) | (89) | (17) | (132) |
| Federal income taxes | (133) | (112) | (3) | (248) | (144) | (113) | (3) | (260) |
| Extraordinary item—early extinguishment of debt | (8) | — | — | (8) | — | — | — | — |
| Net income | <u>\$ 343</u> | <u>\$ 248</u> | <u>\$ 6</u> | <u>\$ 597</u> | <u>\$ 327</u> | <u>\$ 210</u> | <u>\$ 6</u> | <u>\$ 543</u> |

| <u>Nine Months Ended September 30,</u> | <u>1995</u> | | | | <u>1994</u> | | | |
|---|-----------------------------|------------------------|---------------------------|----------------|-----------------------------|------------------------|---------------------------|----------------|
| | <u>Portfolio Investment</u> | <u>Credit Guaranty</u> | <u>Fee-based Services</u> | <u>Total</u> | <u>Portfolio Investment</u> | <u>Credit Guaranty</u> | <u>Fee-based Services</u> | <u>Total</u> |
| | (Dollars in millions) | | | | | | | |
| Net interest income..... | \$1,905 | \$ 278 | \$ 24 | \$2,207 | \$1,842 | \$ 249 | \$ 21 | \$2,112 |
| Guaranty fees | (465) | 1,271 | — | 806 | (424) | 1,238 | — | 814 |
| Gain (loss) on sale of mortgages, net | 3 | — | — | 3 | (2) | — | — | (2) |
| Miscellaneous, net | 13 | — | 66 | 79 | 10 | 13 | 96 | 119 |
| Provision for losses | — | (105) | — | (105) | — | (120) | — | (120) |
| Foreclosed property expenses | — | (146) | — | (146) | — | (171) | — | (171) |
| Administrative expenses | (98) | (264) | (40) | (402) | (76) | (261) | (49) | (386) |
| Federal income taxes | (364) | (314) | (17) | (695) | (415) | (331) | (24) | (770) |
| Extraordinary item—early extinguishment of debt | (11) | — | — | (11) | (17) | — | — | (17) |
| Net income | <u>\$ 983</u> | <u>\$ 720</u> | <u>\$ 33</u> | <u>\$1,736</u> | <u>\$ 918</u> | <u>\$ 617</u> | <u>\$ 44</u> | <u>\$1,579</u> |

Significant Allocation Assumptions

The Portfolio Investment business is charged with a guaranty fee on all mortgages held in portfolio. These fees are paid to the Credit Guaranty business, which assumes the credit risk on all loans.

Administrative expenses are allocated based on direct expenses for the line of business, and, where not identifiable to a particular associated business, based primarily on revenues, profit, or volumes, as applicable.

Net interest income also includes income on capital. Capital is allocated to the separate businesses based on an assessment of the risks associated with each business.

Credit Data

The following table shows the Corporation's serious delinquencies for conventional loans in portfolio and underlying MBS at September 30, 1995 and 1994, and conventional foreclosures and total net charge-offs for the quarters and nine months ended September 30, 1995 and 1994.

| | Delinquency Rate (1) | | Number of Properties Acquired | | | | Net Charge-offs (Dollars in millions) | | | |
|---------------------|----------------------|------|-------------------------------|-------|-------------------|--------|---------------------------------------|------|-------------------|-------|
| | | | Three Months Ended | | Nine Months Ended | | Three Months Ended | | Nine Months Ended | |
| | September 30, | | September 30, | | September 30, | | September 30, | | September 30, | |
| | 1995 | 1994 | 1995 | 1994 | 1995 | 1994 | 1995 | 1994 | 1995 | 1994 |
| Single-family | .60% | .56% | 3,450 | 3,557 | 10,300 | 10,107 | \$35 | \$36 | \$107 | \$114 |
| Multifamily | 1.04 | 1.21 | 9 | 5 | 68 | 24 | 3 | 3 | 10 | 21 |
| Total | | | | | | | \$38 | \$39 | \$117 | \$135 |

- (1) Single-family serious delinquencies consist of those loans in the portfolio or underlying MBS for which the Corporation has the primary risk of loss that are 90 or more days delinquent, in relief, or foreclosure. Multifamily serious delinquencies are those loans in the portfolio or underlying MBS that are 60 days or more delinquent for which the Corporation has primary risk of loss. The single-family and multifamily percentages are based on the number of such single-family loans and dollar amount of such multifamily loans, respectively, in the portfolio and underlying MBS.

The inventory of single-family properties was 6,497 as of September 30, 1995, compared with 6,306 properties as of September 30, 1994. The inventory of multifamily properties was 40 properties as of September 30, 1995, compared with 41 properties as of September 30, 1994. The increase in the number of single-family properties acquired through foreclosure during the first nine months of 1995 was primarily due to the growth in business volumes in recent years. Multifamily REO acquisitions for the first nine months of 1995 included 58 properties from a portfolio that transferred from lender risk to Fannie Mae risk. As part of the transaction, the Corporation received an investment account established by the lender to cover expected losses at the time of transfer.

Total credit-related expenses, which include foreclosed property expenses and the provision for losses, were \$81 million in the third quarter of 1995, compared with \$93 million in the third quarter of 1994. Total credit-related expenses for the nine-month periods ended September 30, 1995 and 1994 were \$251 million and \$291 million, respectively.

The sum of net charge-offs and foreclosed property expenses in the three months ended September 30, 1995 was \$84 million, compared with \$92 million during the same period in 1994. The sum of net charge-offs and foreclosed property expenses for the nine months ended September 30, 1995 and 1994 was \$263 million and \$306 million, respectively. The decrease in net charge-offs and foreclosed property expenses was primarily due to the success of loss mitigation efforts and improvement in Northeast real estate markets.

The allowance for losses was \$815 million at September 30, 1995, compared with \$827 million at December 31, 1994 and \$825 million at September 30, 1994. The Corporation's loss coverage ratio was 5.2 times annualized year-to-date charge-offs at September 30, 1995. Management expects this coverage ratio to decline somewhat over the next few years as the large volume of loans from the early nineties reach their peak default years and the Corporation's portfolio and MBS outstanding continue to grow.

Balance Sheet Analysis

Mortgage Portfolio

The Corporation purchased \$16.3 billion of mortgages at an average yield of 7.51 percent in the third quarter of 1995, compared with \$13.0 billion of mortgages at an average yield of 8.23 percent in the third quarter of 1994. In the first nine months of 1995, mortgage purchases were \$36.8 billion at an average yield of 7.96 percent, compared with \$50.4 billion at an average yield of 7.52 percent in the first nine months of 1994. The lower level of mortgage purchases in the first nine months of 1995 as compared with 1994 was primarily due to a decrease in the early part of 1995 in the number of mortgages offered for sale in the secondary market, resulting in large part from a substantial slowdown in refinancing activity because of rising mortgage rates. The rising interest rate environment at that time also prompted more adjustable-rate loans to be originated, which lenders are more likely to retain or purchase for their portfolio.

Mortgage loan repayments during the third quarter of 1995 totaled \$7.0 billion, compared with \$5.4 billion in the third quarter of 1994. During the first nine months of 1995, mortgage loan repayments were \$15.8 billion compared with \$23.3 billion in the first nine months of 1994. Sales from portfolio were minimal in the third quarter of 1995 and 1994. Sales from portfolio totaled \$0.4 billion for the first nine months of 1995 compared with \$1.7 billion for the first nine months of 1994.

As of September 30, 1995, the net mortgage portfolio totaled \$240.2 billion with a yield (before deducting the allowance for losses) of 7.85 percent, compared with \$220.5 billion at 7.80 percent as of December 31, 1994 and \$214.0 billion at 7.69 percent as of September 30, 1994. The portfolio growth during the third quarter of 1995 was generated by the purchase of a combination of whole loans, MBS, and REMIC tranches. By selectively accessing these markets, the Corporation expects to achieve continued portfolio growth.

At September 30, 1995, the Corporation had mandatory delivery commitments and lender option commitments outstanding to purchase \$4.4 billion and \$0.9 billion of mortgage loans, respectively, compared with \$1.4 billion and \$1.6 billion, respectively, of such commitments outstanding at December 31, 1994.

Financing and Other Activities

During the third quarter of 1995, the Corporation issued \$189.2 billion of debt at an average cost of 5.84 percent and redeemed \$183.1 billion at an average cost of 5.99 percent. Debt issued in the third quarter of 1994 totaled \$162.0 billion at an average cost of 4.93 percent, and debt redeemed was \$150.6 billion at an average cost of 4.42 percent. During the first nine months of 1995, \$568.9 billion of debt was issued at an average cost of 5.99 percent and \$549.1 billion was redeemed at an average cost of 5.96 percent. In the first nine months of 1994, debt issued totaled \$402.1 billion at an average cost of 4.33 percent, and debt redeemed totaled \$364.0 billion at an average cost of 4.01 percent. The average cost of debt outstanding at September 30, 1995, December 31, 1994, and September 30, 1994 was 6.68 percent, 6.78 percent, and 6.56 percent, respectively.

The following table presents the amount of callable debt and the notional amount of callable swaps issued and outstanding for the periods ended September 30, 1995 and September 30, 1994.

| <u>(Dollars in billions)</u> | <u>Three Months Ended</u> <u>September 30,</u> | | <u>Nine Months Ended</u> <u>September 30,</u> | |
|--|---|-------------|--|-------------|
| | <u>1995</u> | <u>1994</u> | <u>1995</u> | <u>1994</u> |
| Issued during the period | \$ 6.6 | \$ 5.8 | \$ 13.1 | \$ 19.7 |
| Percentage of total long-term debt issued(1) | 39% | 39% | 32% | 52% |
| Outstanding at end of period | \$101.7 | \$103.5 | | |
| Percentage of total long-term debt outstanding(1) | 49% | 57% | | |

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

The shift during the first nine months of 1995 from callable to noncallable debt reflected both market conditions and routine mortgage portfolio restructuring. The increase in interest rates during 1994 and the early months of 1995 caused the duration of the mortgage portfolio's assets to extend relative to that of its liabilities, and the issuance of noncallable long-term debt helped to lengthen the duration of the liabilities funding the mortgage portfolio. Issuance of short-maturity bullet debt to refund called and repurchased debt moderated growth in the percentage of callable debt issued during the third quarter of 1995.

The Corporation uses interest rate swaps and other off-balance-sheet financial instruments in its financing activities to manage interest rate risk and to reduce the cost of debt issuance. The Corporation does not engage in trading or other speculative use of such off-balance-sheet financial instruments. Counterparty risk is the primary risk associated with these instruments. The Corporation reduces that risk by dealing only with institutions that meet certain credit guidelines, and by requiring collateral in certain circumstances.

The Corporation uses interest rate swaps primarily to 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. Asset swaps are used to achieve a specific investment objective at a desired yield. The notional amount of interest rate swap agreements outstanding, the weighted-average interest rates receivable and payable under the agreements, and the weighted-average remaining life of the swaps at September 30, 1995 and December 31, 1994 are presented in the following table.

| <u>(Dollars in millions)</u> | <u>Notional</u> <u>Amount (1)</u> | <u>Weighted-Average</u> <u>Interest Rate</u> <u>Receivable (2)</u> | <u>Weighted-Average</u> <u>Interest Rate</u> <u>Payable (2)</u> | <u>Weighted-Average</u> <u>Remaining Life</u> |
|------------------------------|--------------------------------------|--|---|--|
| September 30, 1995 | | | | |
| Interest rate swaps: | | | | |
| Debt | <u>\$115,518</u> | <u>6.05%</u> | <u>6.45%</u> | <u>52 mos</u> |
| Asset | <u>2,068</u> | <u>5.79</u> | <u>5.91</u> | <u>22</u> |
| | <u>\$117,586</u> | | | |
| December 31, 1994 | | | | |
| Interest rate swaps: | | | | |
| Debt | <u>\$ 86,358</u> | <u>5.81%</u> | <u>6.50%</u> | <u>50 mos</u> |
| Asset | <u>1,517</u> | <u>6.37</u> | <u>5.96</u> | <u>25</u> |
| | <u>\$ 87,875</u> | | | |

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

(2) The weighted-average interest rate receivable and payable is as of the date indicated. The interest rates of the swaps may be floating rate, so these rates may change as prevailing interest rates change.

During the first nine months of 1995, the Corporation entered into \$38.9 billion notional amount of interest rate swaps and \$9.2 billion of swaps matured or were called or repurchased.

The exposure to credit loss for interest rate swaps can be estimated by calculating the cost, on a present value basis, to replace at current market rates those swaps outstanding for which the Corporation was in a net gain position. The Corporation's net exposure at September 30, 1995 was \$20.0 million, compared with \$3.0 billion at December 31, 1994. At September 30, 1995 the Corporation had no pledged collateral. At December 31, 1994, the Corporation had collateral with a market value of \$1.2 billion pledged from counterparties to offset credit risk. The exposure to credit loss can be expected to fluctuate significantly due to changes in interest rates.

The Corporation's shareholders' equity at September 30, 1995 was \$10.7 billion, compared with \$9.5 billion at December 31, 1994, and \$9.2 billion at September 30, 1994. During the third quarter of 1995, the Corporation repurchased 0.2 million shares at a cost of \$15.8 million. On October 17, 1995, the Board of Directors approved a dividend on the Corporation's common stock of 68 cents per share for the quarter ended September 30, 1995. As of September 30, 1995, there were 273 million shares of common stock outstanding.

As discussed in the Information Statement under "Management's Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Regulatory Developments," the Corporation is subject to capital standards. The Corporation met the applicable capital standards, as of September 30, 1995. Management expects that continued growth in retained earnings will ensure continued compliance with the applicable standards.

Mortgage-Backed Securities

The Corporation issued \$34.4 billion of MBS during the third quarter of 1995, compared with \$24.6 billion in the third quarter of 1994. MBS issued in the first nine months of 1995 totaled \$68.8 billion, compared with \$111.0 billion in the first nine months of 1994. The decrease in MBS issuances was primarily due to higher interest rates in the early part of 1995 that resulted in less refinance activity and the origination of a higher percentage of adjustable-rate mortgages, which many lenders tend to hold in their portfolio.

REMIC issuances were \$0.6 billion in the third quarter and \$5.1 billion in the first nine months of 1995, compared with \$5.4 billion and \$51.9 billion, respectively, in the comparable periods for 1994. These declines reflected the lower volume of fixed-rate MBS in the higher interest rate environment during the early part of 1995 and a relatively flat yield curve.

The following table summarizes MBS activity for the three-month and nine-month periods ended September 30, 1995 and 1994.

Summary of MBS Activity

(Dollars in millions)

| | Issued | | | | Outstanding (1) | | |
|--|-----------------------|-----------------|-----------------------|-----------|-----------------|---------------------|-----------|
| | Lender Originated (1) | | | | Lender Risk (2) | Fannie Mae Risk (3) | Total (4) |
| Three Months Ended September 30, | Lender Risk | Fannie Mae Risk | Fannie Mae Originated | Total | | | |
| 1995 | \$ 2,897 | \$31,501 | \$ 23 | \$ 34,421 | \$63,154 | \$496,431 | \$559,585 |
| 1994 | 6,434 | 18,061 | 142 | 24,637 | 58,131 | 465,381 | 523,512 |
| Nine Months Ended September 30, | | | | | | | |
| 1995 | \$10,436 | \$57,979 | \$ 406 | \$ 68,821 | | | |
| 1994 | 8,667 | 98,560 | 3,810 | 111,037 | | | |

- (1) This table classifies lender originated MBS issued and MBS outstanding based on primary default risk category; however, Fannie Mae bears the ultimate risk of default on all MBS. MBS outstanding includes MBS that have been pooled to back Megas, SMBS, or REMICs.
- (2) Included in lender risk are \$28.9 billion and \$29.9 billion at September 30, 1995 and 1994, respectively, on which the lender or a third party agreed to bear default risk limited to a certain portion or percentage of the loans delivered and, in some cases, the lender has pledged collateral to secure that obligation.
- (3) Included are \$4.7 billion at September 30, 1995 and \$5.4 billion at September 30, 1994 that are backed by government insured or guaranteed mortgages.
- (4) Included are \$59.1 billion and \$38.0 billion at September 30, 1995 and 1994, respectively, of Fannie Mae MBS in portfolio.

INDEX TO INTERIM FINANCIAL STATEMENTS

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INDEPENDENT ACCOUNTANTS' REVIEW REPORT

The Board of Directors
Fannie Mae:

We have reviewed the accompanying condensed balance sheet of Fannie Mae (Federal National Mortgage Association) as of September 30, 1995 and the related condensed statements of income and cash flows for the three-month and nine-month periods ended September 30, 1995 and 1994. These condensed financial statements are the responsibility of Fannie Mae's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based upon our review, we are not aware of any material modifications that should be made to the accompanying condensed financial statements as of September 30, 1995, and for the three and nine-month periods ended September 30, 1995 and 1994, for them to be in conformity with generally accepted accounting principles.

We have previously audited, in accordance with generally accepted auditing standards, the balance sheet of Fannie Mae as of December 31, 1994 (presented herein in condensed form) and the related statements of income and cash flows for the year then ended (not presented herein); and in our report dated January 11, 1995, we expressed an unqualified opinion on those financial statements. In our opinion, the information set forth in the accompanying condensed balance sheet as of December 31, 1994, is fairly stated, in all material respects, in relation to the balance sheet from which it has been derived.

KPMG PEAT MARWICK LLP

Washington, DC
October 10, 1995

FANNIE MAE
INTERIM FINANCIAL STATEMENTS
CONDENSED STATEMENTS OF INCOME

(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|---------------|------------------------------------|-----------------|
| | 1995 | 1994 | 1995 | 1994 |
| | (Dollars in millions, except per share amounts) | | | |
| Interest income | \$5,336 | \$4,435 | \$15,485 | \$12,604 |
| Interest expense | <u>4,559</u> | <u>3,707</u> | <u>13,278</u> | <u>10,492</u> |
| Net interest income | 777 | 728 | 2,207 | 2,112 |
| Guaranty fees | 272 | 272 | 806 | 814 |
| Gain (loss) on sales of mortgages, net | — | — | 3 | (2) |
| Miscellaneous income, net | 23 | 28 | 79 | 119 |
| Provision for losses | (35) | (40) | (105) | (120) |
| Foreclosed property expenses | (46) | (53) | (146) | (171) |
| Administrative expenses | <u>(138)</u> | <u>(132)</u> | <u>(402)</u> | <u>(386)</u> |
| Income before federal income taxes and extraordinary item | 853 | 803 | 2,442 | 2,366 |
| Provision for federal income taxes | <u>(248)</u> | <u>(260)</u> | <u>(695)</u> | <u>(770)</u> |
| Income before extraordinary item | 605 | 543 | 1,747 | 1,596 |
| Extraordinary loss—early extinguishment of debt (net of tax effect) | <u>(8)</u> | <u>—</u> | <u>(11)</u> | <u>(17)</u> |
| Net income | <u>\$ 597</u> | <u>\$ 543</u> | <u>\$ 1,736</u> | <u>\$ 1,579</u> |
| Per share: | | | | |
| Earnings before extraordinary item | \$ 2.20 | \$ 1.98 | \$ 6.35 | \$ 5.81 |
| Net earnings | 2.17 | 1.98 | 6.31 | 5.75 |
| Cash dividends | 0.68 | 0.60 | 2.04 | 1.80 |

CONDENSED BALANCE SHEETS

(Unaudited)

| | September 30, 1995 | December 31, 1994 |
|--|-----------------------|-----------------------|
| | | (Dollars in millions) |
| Assets | | |
| Mortgage portfolio, net | \$240,218 | \$220,525 |
| Investments | 47,716 | 46,335 |
| Other assets | 6,296 | 5,648 |
| Total assets | <u>\$294,230</u> | <u>\$272,508</u> |
| Liabilities | | |
| Debentures, notes, and bonds, net | | |
| Due within one year | \$127,659 | \$112,602 |
| Due after one year | 149,534 | 144,628 |
| Other liabilities | 6,314 | 5,737 |
| Total liabilities | <u>283,507</u> | <u>262,967</u> |
| Stockholders' equity | <u>10,723</u> | <u>9,541</u> |
| Total liabilities and stockholders' equity | <u>\$294,230</u> | <u>\$272,508</u> |

See Notes to Interim Financial Statements

FANNIE MAE
CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

| | <u>Three Months</u> <u>Ended September 30,</u> | | <u>Nine Months</u> <u>Ended September 30,</u> | |
|---|---|-----------------|--|-----------------|
| | <u>1995</u> | <u>1994</u> | <u>1995</u> | <u>1994</u> |
| | (Dollars in millions) | | | |
| Net cash provided by operating activities | \$ 2,365 | \$ 1,113 | \$ 5,376 | \$ 1,175 |
| Cash flows from investing activities: | | | | |
| Purchases of mortgages | (16,267) | (12,810) | (36,776) | (49,939) |
| Proceeds from sales of mortgages | 78 | 5 | 398 | 1,721 |
| Mortgage principal repayments | 7,498 | 5,953 | 17,212 | 24,774 |
| Net decrease (increase) in investments | <u>624</u> | <u>(5,067)</u> | <u>(1,381)</u> | <u>(13,096)</u> |
| Net cash used in investing activities | <u>(8,067)</u> | <u>(11,919)</u> | <u>(20,547)</u> | <u>(36,540)</u> |
| Cash flows from financing activities: | | | | |
| Cash proceeds from issuance of debt | 188,013 | 161,120 | 565,758 | 406,190 |
| Cash payments to retire debt | (183,061) | (150,553) | (549,885) | (370,152) |
| Other | <u>(197)</u> | <u>(182)</u> | <u>(578)</u> | <u>(455)</u> |
| Net cash provided by financing activities | <u>4,755</u> | <u>10,385</u> | <u>15,295</u> | <u>35,583</u> |
| Net (decrease) increase in cash and cash equivalents | (947) | (421) | 124 | 218 |
| Cash and cash equivalents at beginning of period | <u>1,302</u> | <u>1,616</u> | <u>231</u> | <u>977</u> |
| Cash and cash equivalents at end of period | <u>\$ 355</u> | <u>\$ 1,195</u> | <u>\$ 355</u> | <u>\$ 1,195</u> |

NOTES TO INTERIM FINANCIAL STATEMENTS
(Unaudited)

Basis of Presentation

The accompanying unaudited condensed financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month and nine-month periods ended September 30, 1995 are not necessarily indicative of the results that may be expected for the year ending December 31, 1995. The unaudited interim financial statements should be read in conjunction with the audited financial statements and notes to financial statements that are presented in the Information Statement dated March 31, 1995.

Change in Accounting Principle

In the second quarter of 1995, Fannie Mae adopted, retroactive to January 1, 1995, the equity method of accounting for investments in affordable housing projects in response to an accounting pronouncement issued during the quarter. Previously, the company used the cost recovery method in accounting for these investments. The effect of the change was not material.

NOTES TO INTERIM FINANCIAL STATEMENTS (Continued)

Commitments and Contingencies

The Corporation had outstanding commitments to purchase mortgages and to issue MBS as shown below:

| | <u>September 30, 1995</u> (Dollars in billions) |
|---|--|
| Commitments to purchase mortgages: | |
| Mandatory delivery | \$ 4.4 |
| Lender option (1) | 0.2 |
| Average net yield on mandatory delivery | 7.52% |
| Commitments to issue MBS: | |
| Mandatory delivery (1) | \$ 0.1 |
| Lender option (1) | 2.3 |
| Master commitments: | |
| Mandatory delivery (2) | 36.0 |
| Lender option | 30.0 |

(1) Excludes commitments attached to master commitments, which are included in the total for master commitments.

(2) Under a mandatory master commitment, a lender must either deliver under an MBS contract at a specified guaranty fee or enter into a mandatory portfolio commitment with the yield established upon executing the portfolio commitment.

The Corporation also guarantees timely payment of principal and interest on outstanding MBS and provides credit enhancements or other guarantees as summarized below:

| | <u>September 30, 1995</u> (Dollars in billions) |
|---|--|
| Total MBS outstanding, net of \$59.1 billion of MBS held in portfolio | \$500.4 |
| Amount for which the Corporation has primary foreclosure loss risk(1): | |
| Conventional | 491.7 |
| Government-insured or guaranteed | 4.7 |
| Credit enhancements | 3.1 |
| Other guarantees | 1.3 |

(1) The Corporation, however, assumes the ultimate risk of loss on all MBS.

COMPUTATION OF EARNINGS PER SHARE

(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|--------------|--|--------------|
| | 1995 | 1994 | 1995 | 1994 |
| | (In millions, except per share data) | | | |
| Earnings Per Share: | | | | |
| Average common shares outstanding | 272.7 | 273.5 | 272.7 | 273.4 |
| Effect of common stock equivalents (fully diluted) | <u>2.3</u> | <u>1.2</u> | <u>2.4</u> | <u>1.2</u> |
| Average shares outstanding | <u>275.0</u> | <u>274.7</u> | <u>275.1</u> | <u>274.6</u> |
| | | | | |
| Income before extraordinary item | \$ 605 | \$ 543 | \$1,747 | \$1,596 |
| Net income | 597 | 543 | 1,736 | 1,579 |
| | | | | |
| Earnings per share before extraordinary item | \$2.20 | \$1.98 | \$ 6.35 | \$ 5.81 |
| Net earnings per share | 2.17 | 1.98 | 6.31 | 5.75 |

MANAGEMENT

On November 7, 1995, the President of the United States announced his intention to appoint Kathryn G. Thompson, age 54, to the Board of Directors for a term that expires on May 16, 1996. Ms. Thompson has been Chairman and Chief Executive Officer of Kathryn G. Thompson Company, a building and development company, since 1967. She also serves as a director of the Koll Real Estate Group, Inc. Ms. Thompson resides in Dana Point, California.

