

**Supplement dated August 13, 1998 to  
Information Statement dated March 31, 1998**



This Supplement describes the financial condition of the Federal National Mortgage Association ("Fannie Mae" or the "Corporation") as of June 30, 1998 and contains unaudited financial statements with respect to the Corporation for the quarter and six months ended June 30, 1998. This Supplement should be read in conjunction with the Corporation's Information Statement dated March 31, 1998 (the "Information Statement") and the Supplement dated May 15, 1998 thereto (the "May 15 Supplement"), 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, 1997. The May 15 Supplement describes the financial condition of the Corporation as of March 31, 1998 and contains unaudited financial statements with respect to the Corporation for the quarter ended March 31, 1998. 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 connection 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, a Prospectus or otherwise. This Supplement does not offer any securities for sale.

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 July 31, 1998, approximately 1,026 million 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.**

## TABLE OF CONTENTS

<u>Caption</u>	<u>Page</u>
Selected Financial Data .....	3
Management's Discussion and Analysis of Financial Condition and Results of Operations for the Three-Month and Six-Month Periods Ended June 30, 1998.....	4
Matters Submitted to Stockholders .....	13
Index to Interim Financial Statements .....	13
Management.....	19

## SELECTED FINANCIAL DATA

The following selected financial data for the three- and six-month periods ended June 30, 1998 and 1997 are unaudited and include, in the opinion of management, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation. Certain amounts in 1997 have been reclassified to conform with the current presentation. Operating results for the periods ended June 30, 1998 are not necessarily indicative of the results expected for the entire year.

(Dollars in millions, except per common share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	1998	1997	1998	1997
<b>Income Statement Data:</b>				
Interest income .....	\$ 7,351	\$ 6,514	\$14,376	\$12,843
Interest expense .....	6,320	5,544	12,309	10,923
Net interest income .....	1,031	970	2,067	1,920
Guaranty fees .....	323	317	644	630
Fee and other income, net .....	79	32	135	62
Credit-related expenses .....	(69)	(101)	(146)	(207)
Administrative expenses .....	(174)	(158)	(344)	(309)
Income before federal income taxes and extraordinary item	1,190	1,060	2,356	2,096
Provision for federal income taxes .....	(339)	(308)	(673)	(610)
Income before extraordinary item .....	851	752	1,683	1,486
Extraordinary gain/ (loss), net of tax effect .....	(3)	1	(11)	1
Net income .....	<u>\$ 848</u>	<u>\$ 753</u>	<u>\$ 1,672</u>	<u>\$ 1,487</u>
Preferred stock dividends .....	(16)	(16)	(32)	(32)
Net income available to common stockholders .....	<u>\$ 832</u>	<u>\$ 737</u>	<u>\$ 1,640</u>	<u>\$ 1,455</u>
Basic earnings per common share(1):				
Earnings before extraordinary item .....	\$ .81	\$ .70	\$ 1.60	\$ 1.38
Extraordinary item .....	—	—	(.01)	—
Net earnings .....	<u>\$ .81</u>	<u>\$ .70</u>	<u>\$ 1.59</u>	<u>\$ 1.38</u>
Diluted earnings per common share(1):				
Earnings before extraordinary item .....	\$ .80	\$ .69	\$ 1.59	\$ 1.37
Extraordinary item .....	—	—	(.01)	—
Net earnings .....	<u>\$ .80</u>	<u>\$ .69</u>	<u>\$ 1.58</u>	<u>\$ 1.37</u>
<b>Balance Sheet Data at June 30:</b>				
	1998	1997		
Mortgage portfolio, net .....	\$349,282	\$296,799		
Investments .....	69,643	59,282		
Total assets .....	429,448	365,997		
Borrowings:				
Due within one year .....	174,942	167,682		
Due after one year .....	231,220	177,780		
Total liabilities .....	415,263	352,733		
Stockholders' equity .....	14,185	13,264		
Capital(2) .....	14,973	14,019		
<b>Other Data:</b>				
	1998	1997	1998	1997
Average net interest margin .....	1.07%	1.17%	1.10%	1.17%
Return on average common equity .....	25.6	24.4	25.3	24.3
Dividend payout ratio .....	29.7	29.9	30.3	30.5
Average effective guaranty fee rate .....	.215	.227	.217	.227
Credit loss ratio(3) .....	.030	.047	.032	.046
Ratio of earnings to combined fixed charges and preferred stock dividends(4) .....	1.19:1	1.19:1	1.19:1	1.19:1
Mortgage purchases .....	\$ 44,007	\$ 14,425	\$ 72,379	\$27,421
MBS issued .....	83,880	30,446	142,139	61,327
MBS outstanding at period end(5) .....	761,359	673,931		
Weighted-average diluted common shares outstanding, in millions .....	1,037	1,061	1,041	1,064

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

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

(3) Charge-offs and foreclosure expense as a percentage of average net portfolio and net MBS outstanding.

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

(5) Includes \$156 billion and \$116 billion of MBS held in portfolio at June 30, 1998 and 1997, respectively.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
AND RESULTS OF OPERATIONS FOR THE THREE-MONTH AND  
SIX-MONTH PERIODS ENDED JUNE 30, 1998**

**Results of Operations**

In the second quarter of 1998, Fannie Mae again reported record earnings as net income increased 13 percent, or \$95 million, to \$848 million, compared with the results for the second quarter of 1997. For the first six months of 1998, net income increased \$185 million, or 12 percent, to \$1.672 billion compared with \$1.487 billion for the first half of 1997. The growth in net income for the three- and six-month periods ended June 30, 1998 was mainly attributable to increases in net interest income, fee and other income, and lower credit-related expenses.

Net interest income in the second quarter of 1998 increased 6 percent compared with the second quarter of 1997 as a result of 16 percent growth in the average investment portfolio, which was partly offset by a ten basis point decrease in the average net interest margin. Net interest income in the first six months of 1998 increased 8 percent compared with the first six months of 1997. This increase was the result of a 14 percent growth in the average investment portfolio, which was partly offset by a 7 basis point decrease in the average net interest margin. The decline in the net interest margin stemmed, in part, from an increase in the refinancing of high-coupon mortgages, growth in lower spread liquid investments, a rise in tax advantaged investments, and an increase in common share repurchases. Management expects that continued portfolio growth will have a positive impact on net interest income and that the net interest margin will continue to decline somewhat over the remainder of the year.

The following table presents an analysis of net interest income and average balances for the three- and six-month periods ended June 30, 1998 and 1997.

## Net Interest Income and Average Balances

(Dollars in millions)

	Three Months Ended June 30,		Six Months Ended June 30,	
	1998	1997	1998	1997
Interest income:				
Mortgage portfolio .....	\$ 6,222	\$ 5,621	\$ 12,224	\$ 11,105
Investments and cash equivalents .....	1,129	893	2,152	1,738
Total interest income .....	<u>7,351</u>	<u>6,514</u>	<u>14,376</u>	<u>12,843</u>
Interest expense(1):				
Short-term debt .....	1,131	908	2,096	1,747
Long-term debt .....	5,189	4,636	10,213	9,176
Total interest expense .....	<u>6,320</u>	<u>5,544</u>	<u>12,309</u>	<u>10,923</u>
Net interest income .....	1,031	970	2,067	1,920
Tax equivalent adjustment(2) .....	76	72	148	138
Net interest income tax equivalent basis ...	<u>\$ 1,107</u>	<u>\$ 1,042</u>	<u>\$ 2,215</u>	<u>\$ 2,058</u>
Average balances:				
Interest-earning assets(3):				
Mortgage portfolio, net .....	\$336,064	\$294,953	\$327,976	\$291,425
Investments and cash equivalents .....	78,360	61,978	74,424	61,031
Total interest-earning assets .....	<u>\$414,424</u>	<u>\$356,931</u>	<u>\$402,400</u>	<u>\$352,456</u>
Interest-bearing liabilities(1):				
Short-term debt .....	\$ 83,455	\$ 68,389	\$ 77,619	\$ 66,467
Long-term debt .....	313,083	272,522	307,082	269,990
Total interest-bearing liabilities .....	396,538	340,911	384,701	336,457
Interest-free funds .....	17,886	16,020	17,699	15,999
Total interest-bearing liabilities and interest-free funds .....	<u>\$414,424</u>	<u>\$356,931</u>	<u>\$402,400</u>	<u>\$352,456</u>
Average interest rates(2):				
Interest-earning assets:				
Mortgage portfolio, net .....	7.45%	7.68%	7.50%	7.68%
Investments and cash equivalents .....	5.80	5.82	5.82	5.75
Total interest-earning assets .....	<u>7.14</u>	<u>7.36</u>	<u>7.19</u>	<u>7.35</u>
Interest-bearing liabilities(1):				
Short-term debt .....	5.36	5.29	5.35	5.23
Long-term debt .....	6.63	6.80	6.66	6.80
Total interest-bearing liabilities .....	<u>6.37</u>	<u>6.50</u>	<u>6.39</u>	<u>6.49</u>
Investment spread .....	.77	.86	.80	.86
Interest-free return(4) .....	.30	.31	.30	.31
Net interest margin(5) .....	<u>1.07%</u>	<u>1.17%</u>	<u>1.10%</u>	<u>1.17%</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 \$2.6 billion for the three- and six-month periods ended June 30, 1998 and \$2.2 billion for the three-month period ended June 30, 1997 and \$2.3 billion for the six-month period ended June 30, 1997.

(4) Consists primarily of the return on that portion of the investment portfolio funded by equity and non-interest-bearing liabilities.

(5) Net interest income, on a tax equivalent basis, as a percentage of the average investment portfolio.

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- and six-month periods ended June 30, 1998 and 1997.

### Rate / Volume Analysis

(Dollars in millions)

	Second Quarter 1998 vs. Second Quarter 1997			First Six Months 1998 vs. First Six Months 1997		
	Increase (Decrease)	Attributable to Changes in (1)		Increase (Decrease)	Attributable to Changes in (1)	
		Volume	Rate		Volume	Rate
Interest income:						
Mortgage portfolio .....	\$601	\$ 765	\$(164)	\$1,119	\$1,367	\$(248)
Investments and cash equivalents	236	236	—	414	387	27
Total interest income .....	<u>837</u>	<u>1,001</u>	<u>(164)</u>	<u>1,533</u>	<u>1,754</u>	<u>(221)</u>
Interest expense:						
Short-term debt .....	223	204	19	349	300	49
Long-term debt .....	553	675	(122)	1,037	1,237	(200)
Total interest expense .....	<u>776</u>	<u>879</u>	<u>(103)</u>	<u>1,386</u>	<u>1,537</u>	<u>(151)</u>
Net interest income .....	<u>\$ 61</u>	<u>\$ 122</u>	<u>\$(61)</u>	<u>\$ 147</u>	<u>\$ 217</u>	<u>\$(70)</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 increased by \$6 million, or 2 percent, to \$323 million, compared with \$317 million in the second quarter of 1997. This change resulted from an 8 percent increase in average net Mortgage-Backed Securities (“MBS”) outstanding, which was partially offset by a 1 basis point decrease in the average effective guaranty fee rate when compared with the second quarter of 1997. For the first half of 1998, guaranty fee income increased by \$14 million to \$644 million compared with the first half of 1997. The increase was the result of an increase in average net MBS outstanding of 7 percent, partially offset by a 1 basis point decrease in the average effective guaranty fee rate. The decrease in the average effective guaranty fee rate was due to repayments of loans backing MBS with high fees, an increase in MBS purchased for portfolio for which the guaranty fees are included in net interest income, and an increase in MBS issues incorporating loss sharing arrangements with lower fee rates.

Fee and other income increased 147 percent to \$79 million for the second quarter of 1998 compared with \$32 million in the second quarter of 1997. For the first half of 1998, fee and other income increased 118 percent to \$135 million versus \$62 million in the first half of 1997. The increase in both periods was largely the result of increases in multifamily fees, structured transaction fees and technology fees. Management expects fee and other income to be strong over the remainder of 1998, but at levels somewhat lower than the second quarter of 1998.

Administrative expenses for the second quarter of 1998 were \$174 million, compared with \$158 million during the same period in 1997. For the first half of 1998, administrative expenses were \$344 million, compared with \$309 million for the same period in 1997. The increase was primarily due to higher compensation costs, including costs associated with year 2000 conversion efforts. The ratio of administrative expenses to the average mortgage portfolio plus average MBS outstanding was .074 percent and .075 percent for the three- and six-month periods ended June 30, 1998, respectively, compared with .075 percent and .073 percent for the comparable periods in 1997. The ratio of administrative expenses to revenues (net interest income, guaranty fees and fee and other income) was 12.2 percent for the second quarter of 1998, compared with 12.0 percent for the second quarter of 1997, and was 12.1 percent for the first half of 1998, compared with 11.8 percent for the first half of 1997.

The effective federal income tax rate was 29 percent for the three and six months ended June 30, 1998, and for the three and six months ended June 30, 1997.

In the second quarter of 1998, the Corporation had an extraordinary net loss of \$4 million (\$3 million after tax) from the repurchase or call of debt compared with a gain of \$2 million (\$1 million after tax) in the second quarter of 1997. An extraordinary net loss of \$16 million (\$11 million after tax) was reported in the first half of 1998 from the repurchase or call of debt compared with a gain of \$2 million (\$1 million after tax) in the first half of 1997.

### Credit Data

The following table shows the Corporation's serious delinquencies for conventional loans in portfolio and underlying MBS at June 30, 1998 and 1997, and conventional properties acquired and total net charge-offs for the three- and six-month periods ended June 30, 1998 and 1997.

	Serious Delinquency Rate (1)		Number of Properties Acquired				Net Charge-offs (Dollars in millions)			
			Three Months Ended June 30,		Six Months Ended June 30,		Three Months Ended June 30,		Six Months Ended June 30,	
	1998	1997	1998	1997	1998	1997	1998	1997	1998	1997
Single-family. . . . .	.57%	.58%	5,365	5,717	11,023	11,148	\$(11)	\$34	\$(18)	\$64
Multifamily. . . . .	.36	.47	1	10	5	18	1	5	4	6
Total. . . . .							\$(10)	\$39	\$(14)	\$70

(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 or in 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.

Total credit-related losses, which include loan charge-offs, net of recoveries, and foreclosed property expenses, were \$69 million for the three months ended June 30, 1998, compared with \$100 million for the same period in 1997. Total credit-related losses for the six months ended June 30, 1998 and 1997 were \$147 million and \$197 million, respectively. The change in credit-related losses was the result of a decrease in charge-offs slightly offset by an increase in foreclosure expenses. The decrease in charge-offs was due to net recoveries on foreclosed properties in the second quarter and first half of 1998 versus net charge-offs in the second quarter and first half of 1997. In addition to the Corporation's loss mitigation efforts, a strong economy, a strong housing market, particularly in California, and deeper mortgage insurance requirements on higher loan-to-value ratio loans have contributed to reducing credit-related losses.

The inventory of single-family properties was 9,408 as of June 30, 1998, compared with 9,514 as of June 30, 1997. The inventory of multifamily properties was 13 as of June 30, 1998, compared with 19 as of June 30, 1997.

Total credit-related expenses, which include foreclosed property expenses and the provision for losses, were \$69 million in the second quarter of 1998, compared with \$101 million in the second quarter of 1997. Total credit-related expenses for the six months ended June 30, 1998 and 1997 were \$146 million and \$207 million, respectively. The decreases were due to a negative \$10 million and negative \$15 million loss provision recorded in the second quarter and first half of 1998, respectively, compared with a \$40 million and \$80 million loss provision recorded in the second quarter and first half of 1997, respectively.

The allowance for losses was \$802 million at June 30, 1998, compared with \$803 million at December 31, 1997 and \$790 million at June 30, 1997. Management anticipates that the provision for losses will be adjusted periodically in line with its analysis of actual and expected loss experience.

## **Balance Sheet Analysis**

### *Mortgage Portfolio*

The Corporation purchased \$44 billion of mortgages at an average yield of 6.73 percent in the second quarter of 1998, compared with \$14 billion of mortgages at an average yield of 7.71 percent in the second quarter of 1997. During the first six months of 1998, mortgage purchases were \$72 billion at an average yield of 6.75 percent, compared with \$27 billion at an average yield of 7.65 percent for the first six months of 1997. The increase in mortgage purchases was due primarily to the increased availability of mortgages offered for sale in the secondary market.

Mortgage loan repayments during the second quarter of 1998 totaled \$21 billion, compared with \$8 billion in the second quarter of 1997. During the first half of 1998, mortgage loan repayments were \$38 billion compared with \$16 billion in the first half of 1997.

As of June 30, 1998, the net mortgage portfolio totaled \$349 billion with a yield (before deducting the allowance for losses) of 7.41 percent, compared with \$316 billion at 7.60 percent as of December 31, 1997 and \$297 billion at 7.68 percent as of June 30, 1997. The decrease in yield was due primarily to increased prepayments of higher coupon mortgages and a decrease in conventional mortgage purchase yields as interest rates declined. The portfolio growth during the second quarter and first half of 1998 was generated by the purchase of a combination of whole loans, MBS and REMICs. For the remainder of 1998, the Corporation expects that a high level of fixed-rate mortgage originations will lead to attractive portfolio investment opportunities and growth in the net mortgage portfolio.

At June 30, 1998, the Corporation had mandatory delivery commitments and lender option commitments outstanding to purchase \$14.1 billion and \$1.6 billion of mortgage loans, respectively, compared with \$3.6 billion and \$1.6 billion, respectively, of such commitments outstanding at December 31, 1997.

### *Financing and Other Activities*

During the second quarter of 1998, the Corporation issued \$218 billion of debt at an average cost of 5.63 percent and redeemed \$193 billion at an average cost of 5.71 percent. Debt issued in the second quarter of 1997 totaled \$229 billion at an average cost of 5.64 percent and redeemed \$219 billion at an average cost of 5.58 percent. During the first six months of 1998, \$437 billion of debt was issued at an average cost of 5.63 percent and \$400 billion was redeemed at an average cost of 5.73 percent. In the first six months of 1997, the Corporation issued \$411 billion of debt at an average cost of 5.57 percent and redeemed \$397 billion at an average cost of 5.52 percent. The average cost of debt outstanding at June 30, 1998, December 31, 1997 and June 30, 1997 was 6.33 percent, 6.46 percent and 6.50 percent, respectively.



The following table presents the amount of callable debt and the notional amount of callable swaps issued and outstanding for the three- and six-month periods ended June 30, 1998 and June 30, 1997.

<u>(Dollars in billions)</u>	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>1998</b>	<b>1997</b>	<b>1998</b>	<b>1997</b>
Issued during the period . . . . .	\$ 23	\$ 7	\$42	\$14
Percentage of total long-term debt issued(1) . . . . .	67%	44%	60%	49%
Outstanding at end of period . . . . .	\$149	\$131		
Percentage of total long-term debt outstanding(1) . . . . .	47%	48%		

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

The increase in the percentage of callable debt and callable swaps issued relative to long-term debt issued for the three months ended June 30, 1998, compared with the three months ended June 30, 1997, is due to routine portfolio restructuring and the replacement of callable debt redeemed during the quarter.

The following table summarizes the Corporation's interest rate swap activity, the notional amount of, and weighted-average interest rates to be received and paid on, interest rate swaps outstanding for the quarters ended March 31, 1998 and June 30, 1998, the balance outstanding at June 30, 1997 and the expected maturities for the interest rate swaps outstanding at June 30, 1998.

## Interest Rate Swap Activity Table

(Dollars in millions)	Generic—pay fixed / receive variable (1)			Basis Swaps	Other (4)	Total
	Notional (2)	Pay Rate (3)	Receive Rate (3)			
Balance at December 31, 1997	\$96,713	6.77%	5.82%	\$22,383	\$29,653	\$148,749
Additions .....	—	—	—	3,585	7,436	11,021
Maturities .....	<u>6,993</u>	<u>6.74</u>	<u>5.85</u>	<u>4,370</u>	<u>5,351</u>	<u>16,714</u>
Balance at March 31, 1998 ...	89,720	6.77	5.73	21,598	31,738	143,056
Additions .....	675	6.04	5.83	4,450	12,653	17,778
Maturities .....	<u>5,424</u>	<u>6.88</u>	<u>5.84</u>	<u>5,455</u>	<u>5,884</u>	<u>16,763</u>
Balance at June 30, 1998 .....	<u>\$84,971</u>	<u>6.76%</u>	<u>5.70%</u>	<u>\$20,593</u>	<u>\$38,507</u>	<u>\$144,071</u>
Balance at June 30, 1997 .....	<u>\$96,611</u>	<u>6.78%</u>	<u>5.82%</u>	<u>\$30,882</u>	<u>\$25,521</u>	<u>\$153,014</u>
Future Maturities (5)						
1998 .....	\$ 6,280	5.24%	5.66%	\$ 6,142	\$ 5,475	\$ 17,897
1999 .....	5,450	6.64	5.33	12,352	14,260	32,062
2000 .....	3,817	6.08	5.73	1,200	7,125	12,142
2001 .....	7,300	6.62	5.70	—	3,893	11,193
2002 .....	4,950	6.28	5.70	79	400	5,429
Thereafter .....	<u>57,174</u>	<u>7.04</u>	<u>5.74</u>	<u>820</u>	<u>7,354</u>	<u>65,348</u>
	<u>\$84,971</u>	<u>6.76%</u>	<u>5.70%</u>	<u>\$20,593</u>	<u>\$38,507</u>	<u>\$144,071</u>

(1) Included in the notional amounts are callable swaps of \$22 billion, \$22 billion, and \$26 billion, with weighted-average pay rates of 6.00 percent, 6.60 percent and 6.67 percent, and weighted-average receive rates of 5.79 percent, 5.82 percent and 5.82 percent at June 30, 1998, March 31, 1998, and June 30, 1997, 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. The interest rates of the swaps may be floating rate, so these rates may change as prevailing interest rates change.

(4) Amounts principally consist of generic-pay variable/receive fixed swaps, caps and swaptions.

(5) Assumes that variable interest rates remain constant at June 30, 1998 levels.

The contract amounts of other off-balance-sheet financial instruments, which included futures contracts and derivative instruments that simulate the short sale of Treasury securities to provide a hedge against interest rate fluctuations, credit enhancements and other guarantees, were \$10.4 billion at June 30, 1998, compared with \$11.5 billion at December 31, 1997.

The exposure to credit loss for interest rate swaps and other off-balance-sheet financial instruments can be estimated by calculating the cost, on a present value basis, to replace at current market rates all of those off-balance-sheet financial instruments outstanding for which the Corporation was in a net gain position. The Corporation's net exposure at June 30, 1998 was \$9 million, compared with \$26 million at December 31, 1997. The exposure to credit loss can be expected to fluctuate significantly due to changes in interest rates.

### Capital Resources

The Corporation's stockholders' equity at June 30, 1998 was \$14.2 billion, compared with \$13.8 billion at December 31, 1997, and \$13.3 billion at June 30, 1997. Pursuant, in part, to the

capital restructuring program described in the Information Statement under “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Liquidity and Capital Resources,” the Corporation repurchased 8.6 million common shares at a weighted-average cost of \$60.11 per common share during the second quarter of 1998 and issued .5 million common shares for employee and other stock compensation plans. At June 30, 1998, year-to-date common stock repurchases totaled 14.7 million shares at a weighted-average cost of \$61.02 per common share and common stock issuances totaled 3.7 million common shares for employee and other stock compensation plans. As of June 30, 1998, there were 1,026 million common shares outstanding.

On July 21, 1998, the Board of Directors approved a dividend for the quarter ended June 30, 1998 of \$0.24 per common share, and dividends of \$0.80125 per Series A preferred share, \$0.81250 per Series B preferred share and \$0.80625 per Series C preferred share for the period from and including June 30, 1998 to, but excluding, September 30, 1998.

As discussed in the Information Statement under “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Balance Sheet Analysis—Regulatory Capital Requirements,” the Corporation is subject to capital standards. The Corporation met the applicable capital standards as of June 30, 1998, and management expects that growth in retained earnings will ensure continued compliance with the applicable standards.

### **Mortgage-Backed Securities**

The Corporation issued \$84 billion of MBS during the second quarter of 1998, compared with \$30 billion in the second quarter of 1997. MBS issued in the first half of 1998 totaled \$142 billion, compared with \$61 billion in the first half of 1997. The increase in MBS issued during the first six months of 1998 was primarily due to an increase in mortgage origination and refinance activity in a lower interest rate environment. REMIC issuances were \$25 billion in the second quarter of 1998 and \$42 billion in the first six months of 1998, compared with \$17 billion and \$35 billion, respectively, for the comparable periods for 1997.

The following table summarizes MBS activity for the three-month and six-month periods ended June 30, 1998 and 1997.

### Summary of MBS Activity

(Dollars in millions)

Three Months Ended June 30,	Issued				Outstanding (1)		
	Lender Originated (1)				Lender Risk (2)	Fannie Mae Risk	Total (3)
	Lender Risk	Fannie Mae Risk	Fannie Mae Originated	Total			
1998. ....	\$21,935	\$ 61,945	\$ —	\$ 83,880	\$118,451	\$642,908	\$761,359
1997. ....	6,983	22,479	984	30,446	76,859	597,072	673,931
<b>Six Months Ended June 30,</b>							
1998. ....	\$35,137	\$106,716	\$ 286	\$142,139			
1997. ....	10,677	48,710	1,940	61,327			

- (1) This table classifies lender originated MBS issued and MBS outstanding based on primary default risk category; Fannie Mae, however, 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 \$82 billion and \$40 billion at June 30, 1998 and 1997, 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 \$156 billion and \$116 billion at June 30, 1998 and June 30, 1997, respectively, of Fannie Mae MBS in portfolio.

### New Accounting Standard

In the second quarter of 1998, the Financial Accounting Standards Board issued Financial Accounting Standards No. 133 ("FAS 133"), *Accounting for Derivative Instruments and Hedging Activities*, which becomes effective for Fannie Mae on January 1, 2000. FAS 133 requires all derivatives to be recognized as either assets or liabilities on the balance sheet at fair value. Subject to certain qualifying conditions, a derivative may be designated as either a hedge of the fair value of a fixed-rate instrument ("fair value hedge") or as a hedge of the cash flows of a variable-rate instrument or anticipated transaction ("cash flow hedge"). For derivatives qualifying as a fair value hedge, fair value gains or losses would be reported in earnings along with offsetting fair value gains or losses, attributable to the risk being hedged. For derivatives qualifying as a cash flow hedge, fair value gains or losses associated with the risk being hedged would be reported in a separate component of stockholders' equity and then amortized into earnings in the period(s) in which the hedged item affects income. For a derivative instrument not qualifying as a hedge, fair value gains and losses would be reported in earnings. Management currently is evaluating the impact that this standard will have on its internal operations. If the Corporation continues with its current business strategies, this standard will not have a significant effect on net income, although it may have a material effect on the "other comprehensive income" component of stockholders' equity.

## MATTERS SUBMITTED TO STOCKHOLDERS

At the 1998 Annual Meeting of Stockholders of Fannie Mae held on May 21, 1998, the following matters were presented for a vote: (i) election of 13 members to the Board of Directors, each for a term ending on the date of the next Annual Meeting of Stockholders of the Corporation; (ii) ratification of the appointment of KPMG Peat Marwick LLP as auditors of the Corporation for 1998; and (iii) a stockholder proposal to reinstate cumulative voting for directors. The Board of Directors recommended that stockholders vote against the stockholder proposal for cumulative voting. Under the stockholder proposal relating to cumulative voting, the Board of Directors would have been requested to take the necessary steps to provide for cumulative voting in the election of directors, which would mean that each stockholder would be entitled to as many votes as the number of common shares the stockholder owns multiplied by the number of directors to be elected, and the stockholder could cast all such votes for a single candidate or distribute them among several nominees.

Of the 1,034,195,738 shares of common stock outstanding on the record date for the meeting, 899,663,623 shares were present in person or by proxy at the meeting.

The following persons were elected as directors of Fannie Mae by the respective votes indicated following their names: Stephen B. Ashley (895,751,750 votes for; 3,900,593 votes withheld); Roger E. Birk (895,471,554 votes for; 4,180,789 votes withheld); Kenneth M. Duberstein (899,286,736 votes for; 10,365,607 votes withheld); Stephen Friedman (895,717,483 votes for; 3,934,860 votes withheld); Thomas P. Gerrity (895,623,106 votes for; 4,029,237 votes withheld); Jamie S. Gorelick (895,614,338 votes for; 4,038,005 votes withheld); James A. Johnson (895,677,998 votes for; 3,974,345 votes withheld); Vincent A. Mai (895,746,669 votes for; 3,905,674 votes withheld); Ann McLaughlin (895,168,618 votes for; 4,483,725 votes withheld); Joe K. Pickett (889,358,173 votes for; 10,294,170 votes withheld); Franklin D. Raines (895,597,336 votes for; 4,055,007 votes withheld); Lawrence M. Small (895,693,099 votes for; 3,959,244 votes withheld); Karen Hastie Williams (895,244,258 votes for; 4,408,085 votes withheld).

Messrs. Raines and Duberstein were the only new directors elected and filled the seats vacated by Antonia Shusta and Richard D. Parsons when their terms expired at the May 1998 Annual Meeting. See the May 15 Supplement and the Proxy Statement for the May 1998 Annual Meeting for further information regarding Messrs. Raines and Duberstein.

As noted under "Management," the President of the United States has the authority to appoint five directors. The President has not finalized the selection of these directors.

The ratification of KPMG Peat Marwick LLP as auditors was approved by a vote of 898,157,754 for ratification and 697,362 against ratification. The holders of 797,227 shares of common stock abstained from voting on ratification.

The stockholder proposal relating to cumulative voting was defeated by a vote of 162,745,879 for the proposal and 513,201,536 against the proposal. The holders of 127,788,273 shares abstained from voting on this stockholder proposal and broker non-votes represented 95,916,655 shares of common stock.

## INDEX TO INTERIM FINANCIAL STATEMENTS

<u>Caption</u>	<u>Page</u>
Independent Accountants' Review Report .....	14
Condensed Statements of Income .....	15
Condensed Balance Sheets .....	15
Condensed Statements of Changes in Stockholders' Equity .....	16
Condensed Statements of Cash Flows .....	16
Notes to Interim Financial Statements .....	17
Computation of Earnings Per Common Share .....	19

## INDEPENDENT ACCOUNTANTS' REVIEW REPORT

To the Board of Directors and Stockholders of Fannie Mae:

We have reviewed the accompanying condensed balance sheet of Fannie Mae as of June 30, 1998 and the related condensed statements of income, changes in stockholders' equity, and cash flows for the three- and six-month periods ended June 30, 1998 and 1997. 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 condensed financial statements referred to above 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, 1997 (presented herein in condensed form) and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated January 14, 1998, 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, 1997, 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  
July 14, 1998

**FANNIE MAE**  
**INTERIM FINANCIAL STATEMENTS**  
**CONDENSED STATEMENTS OF INCOME**  
**(Unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	1998	1997	1998	1997
	(Dollars in millions, except per common share amounts)			
Interest income .....	\$7,351	\$6,514	\$14,376	\$12,843
Interest expense .....	6,320	5,544	12,309	10,923
Net interest income .....	1,031	970	2,067	1,920
Guaranty fees .....	323	317	644	630
Fee and other income, net .....	79	32	135	62
Credit-related expenses .....	(69)	(101)	(146)	(207)
Administrative expenses .....	(174)	(158)	(344)	(309)
Income before federal income taxes and extraordinary item .....	1,190	1,060	2,356	2,096
Provision for federal income taxes .....	(339)	(308)	(673)	(610)
Income before extraordinary item .....	851	752	1,683	1,486
Extraordinary (loss) gain—early extinguishment of debt (net of tax effect) .....	(3)	1	(11)	1
Net income .....	<u>\$ 848</u>	<u>\$ 753</u>	<u>\$ 1,672</u>	<u>\$ 1,487</u>
Preferred dividends .....	(16)	(16)	(32)	(32)
Net income available to common stockholders .....	<u>\$ 832</u>	<u>\$ 737</u>	<u>\$ 1,640</u>	<u>\$ 1,455</u>
Basic earnings per common share:				
Earnings before extraordinary item .....	\$ .81	\$ .70	\$ 1.60	\$ 1.38
Extraordinary item .....	—	—	(.01)	—
Net earnings .....	<u>\$ .81</u>	<u>\$ .70</u>	<u>\$ 1.59</u>	<u>\$ 1.38</u>
Diluted earnings per common share:				
Earnings before extraordinary item .....	\$ .80	\$ .69	\$ 1.59	\$ 1.37
Extraordinary item .....	—	—	(.01)	—
Net earnings .....	<u>\$ .80</u>	<u>\$ .69</u>	<u>\$ 1.58</u>	<u>\$ 1.37</u>

**CONDENSED BALANCE SHEETS**  
**(Unaudited)**

	June 30, 1998	December 31, 1997
	(Dollars in millions)	
Assets		
Mortgage portfolio, net .....	\$349,282	\$316,316
Investments .....	69,643	64,596
Other assets .....	10,523	10,761
Total assets .....	<u>\$429,448</u>	<u>\$391,673</u>
Liabilities		
Debentures, notes, and bonds, net:		
Due within one year .....	\$174,942	\$175,400
Due after one year .....	231,220	194,374
Other liabilities .....	9,101	8,106
Total liabilities .....	415,263	377,880
Stockholders' equity .....	14,185	13,793
Total liabilities and stockholders' equity .....	<u>\$429,448</u>	<u>\$391,673</u>

See Notes to Interim Financial Statements

**FANNIE MAE**  
**CONDENSED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
**(Unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	1998	1997	1998	1997
	(Dollars in millions)			
<b>Balance, beginning of period</b> .....	\$14,071	\$13,178	\$13,793	\$12,773
Comprehensive income:				
Net income .....	848	753	1,672	1,487
Other comprehensive income, net of tax—Unrealized gains/(losses) on securities, net .....	—	—	2	(3)
Total comprehensive income .....	848	753	1,674	1,484
Dividends .....	(264)	(237)	(529)	(476)
Shares repurchased .....	(518)	(453)	(895)	(653)
Treasury stock issued for stock options and benefit plans .....	48	23	142	136
<b>Balance, end of period</b> .....	<u>\$14,185</u>	<u>\$13,264</u>	<u>\$14,185</u>	<u>\$13,264</u>

**FANNIE MAE**  
**CONDENSED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	1998	1997	1998	1997
	(Dollars in millions)			
Net cash provided by operating activities. ....	\$ 1,937	\$ 985	\$ 3,641	\$ 3,116
Cash flows from investing activities:				
Purchases of mortgages .....	(44,152)	(14,386)	(72,755)	(27,465)
Proceeds from sales of mortgages .....	—	34	396	131
Mortgage principal repayments .....	22,013	9,249	39,857	17,303
Net increase in investments .....	(2,434)	(2,165)	(5,047)	(2,676)
Net cash used in investing activities .....	<u>(24,573)</u>	<u>(7,268)</u>	<u>(37,549)</u>	<u>(12,707)</u>
Cash flows from financing activities:				
Cash proceeds from issuance of debt .....	213,139	225,529	429,601	404,509
Cash payments to redeem debt .....	(189,284)	(217,644)	(395,764)	(392,826)
Other .....	(771)	(667)	(1,332)	(1,021)
Net cash provided by financing activities ...	<u>23,084</u>	<u>7,218</u>	<u>32,505</u>	<u>10,662</u>
Net increase (decrease) in cash and cash equivalents .....	448	935	(1,403)	1,071
Cash and cash equivalents at beginning of period .....	354	986	2,205	850
Cash and cash equivalents at end of period ...	<u>\$ 802</u>	<u>\$ 1,921</u>	<u>\$ 802</u>	<u>\$ 1,921</u>

See Notes to Interim Financial Statements



**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. Certain amounts in 1997 have been reclassified to conform with the current presentation. Operating results for the three- and six-month periods ended June 30, 1998 are not necessarily indicative of the results that may be expected for the year ending December 31, 1998. 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, 1998.

**Line of Business Reporting**

The following tables set forth the Corporation's financial information by line of business for the three and six months ended June 30, 1998 and 1997. Significant changes from period to period were due to the same factors discussed under "Results of Operations."

<u>Three months ended June 30,</u>	<u>1998</u>			<u>1997</u>		
	<u>Portfolio Investment</u>	<u>Credit Guaranty</u>	<u>Total</u>	<u>Portfolio Investment</u>	<u>Credit Guaranty</u>	<u>Total</u>
	(Dollars in millions)					
Net interest income .....	\$ 862	\$ 169	\$1,031	\$ 859	\$ 111	\$ 970
Guaranty fees .....	(203)	526	323	(191)	508	317
Fee and other income, net .....	16	63	79	4	28	32
Credit-related expenses .....	—	(69)	(69)	—	(101)	(101)
Administrative expenses .....	(38)	(136)	(174)	(37)	(121)	(158)
Federal income taxes .....	(170)	(169)	(339)	(176)	(132)	(308)
Extraordinary item—early extinguishment of debt .....	(3)	—	(3)	1	—	1
Net income .....	<u>\$ 464</u>	<u>\$ 384</u>	<u>\$ 848</u>	<u>\$ 460</u>	<u>\$ 293</u>	<u>\$ 753</u>

<u>Six months ended June 30,</u>	<u>1998</u>			<u>1997</u>		
	<u>Portfolio Investment</u>	<u>Credit Guaranty</u>	<u>Total</u>	<u>Portfolio Investment</u>	<u>Credit Guaranty</u>	<u>Total</u>
	(Dollars in millions)					
Net interest income .....	\$1,755	\$ 312	\$2,067	\$1,707	\$ 213	\$1,920
Guaranty fees .....	(400)	1,044	644	(380)	1,010	630
Fee and other income, net .....	32	103	135	12	50	62
Credit-related expenses .....	—	(146)	(146)	—	(207)	(207)
Administrative expenses .....	(74)	(270)	(344)	(73)	(236)	(309)
Federal income taxes .....	(356)	(317)	(673)	(353)	(257)	(610)
Extraordinary item—early extinguishment of debt .....	(11)	—	(11)	1	—	1
Net income .....	<u>\$ 946</u>	<u>\$ 726</u>	<u>\$1,672</u>	<u>\$ 914</u>	<u>\$ 573</u>	<u>\$1,487</u>

The Portfolio Investment business represented \$419 billion, or 98 percent of total assets, at June 30, 1998 and \$351 billion, or 96 percent of total assets, at June 30, 1997.

**NOTES TO INTERIM FINANCIAL STATEMENTS (Continued)**

**Commitments and Contingencies**

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

	<b>June 30, 1998</b>
	<b>(Dollars in billions)</b>
<b>Commitments to purchase mortgages:</b>	
Mandatory delivery .....	\$14.1
Optional delivery (1) .....	1.6
Average net yield on mandatory delivery .....	6.74%
<b>Commitments to issue MBS:</b>	
Mandatory delivery (1) .....	\$ —
Optional delivery (1) .....	.1
<b>Master commitments:</b>	
Mandatory delivery (2) .....	45.3
Optional delivery .....	69.7

(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:

	<b>June 30, 1998</b>
	<b>(Dollars in billions)</b>
MBS(1) .....	\$761
MBS for which the Corporation has primary foreclosure loss risk .....	643
Credit enhancements .....	5.7
Other guarantees .....	2.8

(1) Includes \$156 billion of MBS held in portfolio and net of \$542 million in allowance for losses. The Corporation assumes the ultimate risk of loss on all MBS.

**COMPUTATION OF EARNINGS PER COMMON SHARE**  
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	1998	1997	1998	1997
	(In millions, except per common share data)			
Numerator:				
Net income before extraordinary loss . . . . .	\$851	\$752	\$1,683	\$1,486
Extraordinary gain (loss) . . . . .	(3)	1	(11)	1
Preferred stock dividends . . . . .	(16)	(16)	(32)	(32)
Basic and diluted earnings per common share-income available to common stockholders . . . . .	<u>\$832</u>	<u>\$737</u>	<u>\$1,640</u>	<u>\$1,455</u>
Denominator:				
Basic earnings per common share-weighted-average common shares . . . . .	1,029	1,051	1,033	1,056
Dilutive potential common shares(1) . . . . .	8	10	8	8
Diluted earnings per common share-adjusted weighted average common shares . . . . .	<u>1,037</u>	<u>1,061</u>	<u>1,041</u>	<u>1,064</u>
Basic earnings per common share:				
Earnings before extraordinary item . . . . .	\$ .81	\$ .70	\$ 1.60	\$ 1.38
Net earnings . . . . .	.81	.70	1.59	1.38
Diluted earnings per common share:				
Earnings before extraordinary item . . . . .	\$ .80	\$ .69	\$ 1.59	\$ 1.37
Net earnings . . . . .	.80	.69	1.58	1.37

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

---

**MANAGEMENT**

As discussed under “Matters Submitted to Stockholders,” at the Annual Meeting of Stockholders in May 1998, thirteen directors, including two new directors, were elected to serve a one-year term ending on the date of the May 1999 Annual Meeting. The President of the United States has the authority to appoint five directors. As of August 12, 1998, the President of the United States had not finalized the selection of these directors.

In June 1998, two executive vice presidents accepted new responsibilities. Robert Levin became Executive Vice President—Housing and Community Development, a new position responsible for the Corporation’s National Housing Impact Division, multifamily lending, the American Communities Fund, 31 Partnership Offices and the Housing Impact Fund. Ann Logan became Executive Vice President—Single-Family Mortgage Business, responsible for the Corporation’s single-family business, credit product development and management, pricing, the Corporation’s sales force, credit loss management and, in concert with the Corporation’s Executive Vice President and Chief Information Officer, technology products marketing.

In July 1998, the Board elected Adolfo Marzol Executive Vice President and Chief Credit Officer. Mr. Marzol was Senior Vice President—Single-Family Business from July 1996 and Senior Vice President—Capital Markets from February 1996 to July 1996. Prior to joining the Corporation, Mr. Marzol was Executive Vice President and Chief Financial Officer from July 1993 to January 1996 of Chase Manhattan Mortgage Corporation, a mortgage company. Management also announced that Kenneth J. Bacon, Senior Vice President—Northeastern Regional Office since May 1993, will become the head of the Community Development Capital Corporation which consists of the American Communities Fund and the Housing Impact Fund.



**FannieMae**