

**Supplement dated November 13, 1996 to  
Information Statement dated February 22, 1996**



This Supplement describes the financial condition of the Federal National Mortgage Association ("Fannie Mae" or the "Corporation") as of September 30, 1996 and contains unaudited financial statements with respect to the Corporation for the quarter and nine months ended September 30, 1996. This Supplement should be read in conjunction with the Corporation's Information Statement dated February 22, 1996 (the "Information Statement"), and the Supplements thereto dated May 15, 1996 and August 13, 1996 (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, 1995. The May 15, 1996 and August 13, 1996 Supplements describe the financial condition of the Corporation as of March 31, 1996 and June 30, 1996, 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, 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, 1996, approximately 1,062 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 Nine-Month Periods Ended September 30, 1996 .....	4
Recent Legislative and Regulatory Developments .....	12
Index to Interim Financial Statements .....	13
Management .....	18

## SELECTED FINANCIAL DATA

The following selected financial data for the three-month and nine-month periods ended September 30, 1996 and 1995 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, 1996 are not necessarily indicative of the results expected for the entire year.

(Dollars and shares in millions, except per share amounts)

Income Statement Data:	Three Months Ended September 30,		Nine Months Ended September 30,	
	1996	1995	1996	1995
Interest income .....	\$ 5,993	\$ 5,336	\$ 17,583	\$15,485
Interest expense .....	5,093	4,559	14,914	13,278
Net interest income .....	900	777	2,669	2,207
Guaranty fees .....	303	272	887	806
Miscellaneous income, net .....	20	23	57	82
Provision for losses .....	(50)	(35)	(145)	(105)
Foreclosed property expenses .....	(52)	(46)	(157)	(146)
Administrative expenses .....	(142)	(138)	(415)	(402)
Income before federal income taxes and extraordinary item .....	979	853	2,896	2,442
Provision for federal income taxes .....	(289)	(248)	(855)	(695)
Income before extraordinary item .....	690	605	2,041	1,747
Extraordinary loss, net of tax effect .....	—	(8)	(29)	(11)
Net income .....	<u>\$ 690</u>	<u>\$ 597</u>	<u>\$ 2,012</u>	<u>\$ 1,736</u>
Preferred stock dividends .....	(12)	—	(25)	—
Net income available to common stockholders .....	<u>\$ 678</u>	<u>\$ 597</u>	<u>\$ 1,987</u>	<u>\$ 1,736</u>
Per common share:				
Earnings before extraordinary item .....	\$ .63	\$ .55	\$ 1.86	\$ 1.59
Net earnings .....	.63	.54	1.83	1.58
Cash dividends .....	.19	.17	.57	.51
	September 30,			
	1996	1995		
<b>Balance Sheet Data:</b>				
Mortgage portfolio, net .....	\$277,016	\$240,218		
Investments .....	53,944	47,716		
Total assets .....	338,534	294,230		
Borrowings:				
Due within one year .....	151,549	127,659		
Due after one year .....	167,604	149,534		
Total liabilities .....	326,267	283,507		
Stockholders' equity .....	12,267	10,723		
	Three Months Ended September 30,		Nine Months Ended September 30,	
	1996	1995	1996	1995
<b>Other Data:</b>				
Net interest margin .....	1.17%	1.17%	1.18%	1.15%
Return on average common equity .....	24.5	22.8	24.1	23.0
Return on average assets .....	.82	.82	.81	.83
Ratio of earnings to combined fixed charges and preferred stock dividends (1) .....	1.19:1	1.18:1	1.19:1	1.18:1
Dividend payout ratio .....	29.8%	31.1%	30.9%	32.1%
Equity to assets ratio .....	3.6	3.6	3.5	3.6
Credit loss ratio (2) .....	.047	.046	.054	.049
Average shares outstanding .....	1,075	1,100	1,086	1,100
Mortgage purchases .....	\$ 16,058	\$ 16,347	\$ 51,400	\$36,764
MBS issued .....	33,844	34,421	118,195	68,821
MBS outstanding at period end .....	636,362	559,585		
Capital at period end (3) .....	13,046	11,537		
Book value per common share .....	10.62	9.83		

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

(2) Charge-offs and foreclosed property expenses as a percentage of average net portfolio and net MBS.

(3) 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, 1996**

**Results of Operations**

In the third quarter of 1996, Fannie Mae again reported record earnings as net income increased \$93 million to \$690 million or 16 percent over the results for the third quarter of 1995. For the first nine months of 1996, net income increased \$276 million or 16 percent to \$2.012 billion compared with \$1.736 billion for the first nine months of 1995. The growth in net income for the three-month and nine-month periods ended September 30, 1996 was attributable mainly to increases in net interest income and guaranty fee income.

Net interest income in the third quarter of 1996 increased 16 percent compared with the third quarter of 1995, primarily as a result of 16 percent growth in the average net investment balance. The net interest margin was 117 basis points in the third quarter of 1996 and 1995. Net interest income in the first nine months of 1996 increased 21 percent, compared with the first nine months of 1995, primarily as a result of 17 percent growth in the average net investment balance and a 3 basis point increase in the net interest margin. Management believes that net interest income will continue to expand in the fourth quarter of 1996 due to portfolio growth and that the net interest margin for 1996 as a whole will not be significantly different from the average for the first nine months of the year.

The following table presents an analysis of net interest income for the three-month and nine-month periods ended September 30, 1996 and 1995.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1996	1995	1996	1995
Interest income:				
Mortgage portfolio	\$ 5,216	\$ 4,603	\$ 15,194	\$ 13,364
Investments and cash equivalents	777	733	2,389	2,121
Total interest income	<u>5,993</u>	<u>5,336</u>	<u>17,583</u>	<u>15,485</u>
Interest expense (1):				
Short-term debt	786	1,037	2,613	2,980
Long-term debt	4,307	3,522	12,301	10,298
Total interest expense	<u>5,093</u>	<u>4,559</u>	<u>14,914</u>	<u>13,278</u>
Net interest income	900	777	2,669	2,207
Tax equivalent adjustment (2)	64	52	182	154
Net interest income tax equivalent basis	<u>\$ 964</u>	<u>\$ 829</u>	<u>\$ 2,851</u>	<u>\$ 2,361</u>
Average balances:				
Interest-earning assets (3):				
Mortgage portfolio, net	\$272,952	\$235,618	\$264,617	\$227,774
Investments and cash equivalents	55,236	48,470	56,821	46,225
Total interest-earning assets	<u>\$328,188</u>	<u>\$284,088</u>	<u>\$321,438</u>	<u>\$273,999</u>
Interest-bearing liabilities (1):				
Short-term debt	\$ 59,980	\$ 69,353	\$ 65,304	\$ 67,038
Long-term debt	253,328	201,572	241,034	194,040
Total interest-bearing liabilities	313,308	270,925	306,338	261,078
Interest-free funds	14,880	13,163	15,100	12,921
Total interest-bearing liabilities and interest-free funds	<u>\$328,188</u>	<u>\$284,088</u>	<u>\$321,438</u>	<u>\$273,999</u>
Average interest rates (2):				
Interest-earning assets:				
Mortgage portfolio, net	7.70%	7.86%	7.72%	7.86%
Investments and cash equivalents	5.69	6.13	5.66	6.21
Total interest-earning assets	<u>7.37</u>	<u>7.57</u>	<u>7.36</u>	<u>7.58</u>
Interest-bearing liabilities (1):				
Short-term debt	5.16	5.82	5.24	5.93
Long-term debt	6.81	7.03	6.82	7.09
Total interest-bearing liabilities	<u>6.50</u>	<u>6.72</u>	<u>6.49</u>	<u>6.79</u>
Investment spread	.87	.85	.87	.79
Miscellaneous (4)	.30	.32	.31	.36
Net interest margin (5)	<u>1.17%</u>	<u>1.17%</u>	<u>1.18%</u>	<u>1.15%</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 \$2.2 billion for the three- and nine-month periods ended September 30, 1996 and \$1.9 billion for the three- and nine-month periods ended September 30, 1995.
- (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-month and nine-month periods ended September 30, 1996 and 1995.

### Rate/Volume Analysis

(Dollars in millions)

	Third Quarter 1996 vs. Third Quarter 1995			First Nine Months 1996 vs. First Nine Months 1995		
	Increase (Decrease)	Attributable to Changes in (1)		Increase (Decrease)	Attributable to Changes in (1)	
		Volume	Rate		Volume	Rate
Interest income:						
Mortgage portfolio.....	\$ 613	\$ 715	\$(102)	\$1,830	\$2,121	\$(291)
Investments and cash equivalents ...	44	98	(54)	268	456	(188)
Total interest income .....	657	813	(156)	2,098	2,577	(479)
Interest expense:						
Short-term debt .....	(251)	(131)	(120)	(367)	(75)	(292)
Long-term debt .....	785	882	(97)	2,003	2,411	(408)
Total interest expense .....	534	751	(217)	1,636	2,336	(700)
Net interest income.....	\$ 123	\$ 62	\$ 61	\$ 462	\$ 241	\$ 221

(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 \$31 million to \$303 million compared with \$272 million in the third quarter of 1995. This change resulted from a 9 percent increase in average net MBS outstanding and a 0.4 basis point increase in the effective guaranty fee rate. For the first nine months of 1996, guaranty fee income increased by \$81 million to \$887 million, compared with \$806 million for the same period in 1995.

In the third quarter of 1996, miscellaneous income decreased by 13 percent to \$20 million versus \$23 million in the third quarter of 1995. For the first nine months of 1996, miscellaneous income declined by 30 percent to \$57 million versus \$82 million in the first nine months of 1995. The decreases for both the three and nine month periods were primarily a result of lower REMIC fees, partially offset by an increase in other miscellaneous fees. Net REMIC fees decreased by \$4 million to a total of \$5 million in the third quarter of 1996 versus \$9 million in the third quarter of 1995. Net REMIC fees were \$15 million for the first nine months of 1996 compared with \$49 million in the first nine months of 1995. In the first nine months of 1995, the Corporation recognized additional deferred REMIC fees due to lower expected REMIC processing costs as a result of technology improvements and the associated transfer of administrative processes from external to internal sources.

Administrative expenses for the quarter ended September 30, 1996 were \$142 million, compared with \$138 million during the same period in 1995. For the nine months ended September 30, 1996, administrative expenses were \$415 million, compared with \$402 million for the same period in 1995. The ratio of administrative expenses to the average mortgage portfolio plus average MBS outstanding was .070 percent (annualized) for the three months and nine months ended September 30, 1996 compared with .075 percent (annualized) for the three months and the nine months ended September 30, 1995. The ratio of administrative expenses to revenues (net interest income, guaranty fees, and miscellaneous income) was 11.6 percent for the third quarter of 1996, compared with 12.8 percent for the third quarter 1995, and was 11.5 percent for the first nine months of 1996, compared with 13.0 percent for the first nine months of 1995.

The effective federal income tax rate was 30 percent for the third quarter of 1996 and 29 percent for the first nine months of 1996, compared with 29 and 28 percent for the three- and nine-month periods ended September 30, 1995, respectively. Management anticipates that the effective federal income tax rate for all of 1996 will be close to the percentage for the first nine months of the year.

In the third quarter of 1996, the Corporation had no losses from the repurchase or call of debt compared with an extraordinary loss of \$12 million (\$8 million after tax) in the third quarter of 1995. An extraordinary loss of \$44 million (\$29 million after tax) was reported in the first nine months of 1996 from the repurchase or call of debt, compared with a loss of \$17 million (\$11 million after tax) from repurchases or calls in the first nine months of 1995. 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

The following tables set forth the Corporation's financial information by line of business for the three months and nine months ended September 30, 1996 and 1995. Significant changes from period to period were due to the same factors discussed under "Results of Operations."

Three Months Ended September 30,	1996				1995			
	Portfolio Investment	Credit Guaranty	Fee-based Services	Total	Portfolio Investment	Credit Guaranty	Fee-based Services	Total
	(Dollars in millions)							
Net interest income.....	\$ 800	\$ 93	\$ 7	\$ 900	\$ 668	\$ 101	\$ 8	\$ 777
Guaranty fees .....	(181)	484	—	303	(158)	430	—	272
Miscellaneous, net .....	6	2	12	20	8	(1)	16	23
Provision for losses .....	—	(50)	—	(50)	—	(35)	—	(35)
Foreclosed property expenses .....	—	(52)	—	(52)	—	(46)	—	(46)
Administrative expenses .....	(33)	(89)	(20)	(142)	(34)	(89)	(15)	(138)
Federal income taxes .....	(166)	(123)	—	(289)	(133)	(112)	(3)	(248)
Extraordinary item—early extinguishment of debt.....	—	—	—	—	(8)	—	—	(8)
Net income .....	<u>\$ 426</u>	<u>\$ 265</u>	<u>\$ (1)</u>	<u>\$ 690</u>	<u>\$ 343</u>	<u>\$ 248</u>	<u>\$ 6</u>	<u>\$ 597</u>

  

Nine Months Ended September 30,	1996				1995			
	Portfolio Investment	Credit Guaranty	Fee-based Services	Total	Portfolio Investment	Credit Guaranty	Fee-based Services	Total
	(Dollars in millions)							
Net interest income.....	\$2,355	\$ 291	\$ 23	\$2,669	\$1,905	\$ 278	\$ 24	\$2,207
Guaranty fees .....	(538)	1,425	—	887	(465)	1,271	—	806
Miscellaneous, net .....	20	(2)	39	57	16	—	66	82
Provision for losses .....	—	(145)	—	(145)	—	(105)	—	(105)
Foreclosed property expenses .....	—	(157)	—	(157)	—	(146)	—	(146)
Administrative expenses .....	(96)	(265)	(54)	(415)	(98)	(264)	(40)	(402)
Federal income taxes .....	(490)	(362)	(3)	(855)	(364)	(314)	(17)	(695)
Extraordinary item—early extinguishment of debt.....	(29)	—	—	(29)	(11)	—	—	(11)
Net income .....	<u>\$1,222</u>	<u>\$ 785</u>	<u>\$ 5</u>	<u>\$2,012</u>	<u>\$ 983</u>	<u>\$ 720</u>	<u>\$ 33</u>	<u>\$1,736</u>

The portfolio investment business represented \$326 billion, or 96 percent of total assets, at September 30, 1996 and \$278 billion, or 94 percent of total assets, at September 30, 1995.

## Credit Data

The following table shows the Corporation's serious delinquencies for conventional loans in portfolio and underlying MBS at September 30, 1996 and 1995, and conventional properties acquired and total net charge-offs for the quarters and nine months ended September 30, 1996 and 1995.

	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, 1996	September 30, 1995	September 30, 1996	September 30, 1995	September 30, 1996	September 30, 1995	September 30, 1996	September 30, 1995	September 30, 1996	September 30, 1995
Single-family .....	.56%	.52%	5,572	3,450	15,139	10,300	\$42	\$35	\$152	\$107
Multifamily .....	.91	1.04	14	9	41	68	<u>1</u>	<u>3</u>	<u>9</u>	<u>10</u>
Total .....							<u>\$43</u>	<u>\$38</u>	<u>\$161</u>	<u>\$117</u>

- (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.

The increases in single-family properties acquired and net charge-offs primarily reflected the aging of the Corporation's overall book of business, higher loan-to-value ratios on the 1994 and 1995 books of business, the decline in California real estate values in prior years and initiatives undertaken by the Corporation to reduce the time required for foreclosure processing.

Multifamily property acquisitions included 10 properties in the third quarter of 1996 and 5 properties in the third quarter of 1995 from a portfolio that transferred from lender risk to Fannie Mae risk. For the nine months ended September 30, 1996 and 1995, multifamily property acquisitions included 30 and 58 properties, respectively, related to this portfolio. As part of this transaction, the Corporation received substantial supplemental fees to help offset expected losses.

The inventory of single-family properties was 9,115 as of September 30, 1996, compared with 6,497 as of September 30, 1995. The inventory of multifamily properties was 37 as of September 30, 1996, compared with 40 as of September 30, 1995.

Total credit-related expenses, which include foreclosed property expenses and the provision for losses, were \$102 million in the third quarter of 1996, compared with \$81 million in the third quarter of 1995. Total credit-related expenses for the nine months ended September 30, 1996 and 1995 were \$302 million and \$251 million, respectively. Total credit-related losses, which includes charge-offs and foreclosed property expenses, for the three months ended September 30, 1996 was \$95 million, compared with \$84 million during the same period in 1995. Total credit-related losses for the nine months ended September 30, 1996 and 1995 were \$318 million and \$263 million, respectively. The increases in total credit-related expenses and losses in the three- and nine-month periods were primarily due to higher property acquisitions.

The allowance for losses decreased to \$779 million at September 30, 1996, compared with \$795 million at December 31, 1995 and \$815 million at September 30, 1995. The allowance for losses increases through the provision for losses and is reduced through charge-offs. The provision for losses was \$50 million in the third quarter of 1996, compared with \$35 million in the third quarter of 1995, and \$145 million in the first nine months of 1996 versus \$105 million in the comparable period in 1995. At September 30, 1996 the Corporation's loss coverage ratio was 3.6 times charge-offs for the period then ended. 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 \$16.1 billion of mortgages at an average yield of 7.92 percent in the third quarter of 1996, compared with \$16.3 billion of mortgages at an average yield of 7.51 percent in the third quarter of 1995. In the first nine months of 1996, mortgage purchases were \$51.4 billion at an average yield of 7.58 percent, compared with \$36.8 billion at an average yield of 7.96 percent in the first nine months of 1995. The increase in mortgage purchases in 1996 was primarily due to the increase in the number of mortgages offered for sale in the secondary market.

Mortgage loan repayments during the third quarter of 1996 totaled \$7.6 billion, compared with \$7.0 billion in the third quarter of 1995. During the first nine months of 1996, mortgage loan repayments were \$25.3 billion compared with \$15.8 billion in the first nine months of 1995.

As of September 30, 1996, the net mortgage portfolio totaled \$277.0 billion with a yield (before deducting the allowance for losses) of 7.71 percent, compared with \$252.6 billion at 7.80 percent as of December 31, 1995 and \$240.2 billion at 7.85 percent as of September 30, 1995. The portfolio growth during the third quarter of 1996 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, 1996, the Corporation had mandatory delivery commitments and lender option commitments outstanding to purchase \$3.1 billion and \$1.1 billion of mortgage loans, respectively, compared with \$2.5 billion and \$0.7 billion, respectively, of such commitments outstanding at December 31, 1995.

### *Financing and Other Activities*

During the third quarter of 1996, the Corporation issued \$181.4 billion of debt at an average cost of 5.54 percent and redeemed \$170.4 billion at an average cost of 5.46 percent. Debt issued in the third quarter of 1995 totaled \$189.2 billion at an average cost of 5.84 percent, and debt redeemed was \$183.1 billion at an average cost of 5.99 percent. During the first nine months of 1996, \$526.7 billion of debt was issued at an average cost of 5.51 percent and \$506.7 billion was redeemed at an average cost of 5.53 percent. In the first nine months of 1995, debt issued totaled \$568.9 billion at an average cost of 5.99 percent, and debt redeemed totaled \$549.1 billion at an average cost of 5.96 percent. The average cost of debt outstanding at September 30, 1996, December 31, 1995, and September 30, 1995 was 6.52 percent, 6.55 percent, and 6.68 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, 1996 and September 30, 1995.

<u>(Dollars in billions)</u>	<u>Three Months Ended</u> <u>September 30,</u>		<u>Nine Months Ended</u> <u>September 30,</u>	
	<u>1996</u>	<u>1995</u>	<u>1996</u>	<u>1995</u>
Issued during the period .....	\$ 9.1	\$ 6.6	\$ 32.9	\$13.1
Percentage of total long-term debt issued(1) .....	51%	39%	52%	32%
Outstanding at end of period .....	\$122.7	\$101.7		
Percentage of total long-term debt outstanding(1) ..	48%	49%		

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

The shift to more callable debt in the third quarter and first nine months of 1996 as compared with the third quarter and first nine months of 1995, respectively, reflected market conditions and restructuring of the duration of the Corporation's debt, which supports the mortgage portfolio.



Callable debt enables the Corporation to shorten the duration of its debt when interest rates fall, and to lengthen the duration of that same debt when interest rates rise.

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 primarily uses two types of interest rate swaps—generic swaps, which involve the exchange of fixed and variable interest payments based on contractual notional principal amounts and may include callable swaps (which give the Corporation the right to terminate the interest rate swap transaction prior to its stated final maturity); and basis swaps, whereby the Corporation exchanges variable interest payments that have similar maturities but are based on different indices. The following table summarizes the Corporation's interest rate swap activity for the quarter ended September 30, 1996 and the balance of swaps outstanding at September 30, 1996, together with the expected maturities and weighted-average interest rates to be received and paid on these swaps.

## Interest Rate Swap Activity Table

(Dollars in billions)	Generic—pay fixed/ receive variable (1)			Basis Swaps	Other (4)	Total
	Notional (2)	Pay Rate (3)	Receive Rate (3)			
Balance at December 31, 1995 . . . .	\$75.5	6.68%	5.87%	\$32.9	\$14.8	\$123.2
Additions . . . . .	5.1	6.05	5.44	6.8	3.2	15.1
Maturities . . . . .	1.0	6.03	5.38	4.0	7.4	12.4
Balance at March 31, 1996 . . . . .	79.6	6.65	5.52	35.7	10.6	125.9
Additions . . . . .	9.5	7.31	5.57	7.1	5.0	21.6
Maturities . . . . .	1.4	6.65	5.56	3.0	2.0	6.4
Balance at June 30, 1996 . . . . .	87.7	6.72	5.50	39.8	13.6	141.1
Additions . . . . .	7.7	7.18	5.53	7.8	2.9	18.4
Maturities . . . . .	.5	5.77	5.36	4.9	1.2	6.6
Balance at September 30, 1996 . . .	\$94.9	6.76%	5.61%	\$42.7	\$15.3	\$152.9
Balance at September 30, 1995 . . .	\$70.6	6.78%	5.99%	\$28.0	\$16.9	\$115.5
Future Maturities (5)						
1996 . . . . .	\$ .9	6.48%	5.52%	\$ 7.8	\$ .5	\$ 9.2
1997 . . . . .	9.9	6.17	5.67	27.1	4.0	41.0
1998 . . . . .	9.3	5.34	5.58	3.4	1.8	14.5
1999 . . . . .	8.5	6.77	5.41	3.2	4.7	16.4
2000 . . . . .	4.2	6.15	5.63	.9	.9	6.0
Thereafter . . . . .	62.1	7.11	5.63	.3	3.4	65.8
	\$94.9	6.76%	5.61%	\$42.7	\$15.3	\$152.9

(1) Included in the notional amounts are callable swaps of \$30.5 billion, \$27.8 billion, \$23.6 billion, \$23.4 billion and \$25.4 billion at September 30, 1996, June 30, 1996, March 31, 1996, December 31, 1995, and September 30, 1995, respectively.

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

(3) The weighted-average interest rate receivable and payable is as of the date indicated. 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.

(5) Assumes that variable interest rates remain constant at September 30, 1996 levels.

The contract amounts of other off-balance-sheet financial instruments, which included futures contracts and short sales of Treasury securities to provide a hedge against interest rate fluctuations, credit enhancements and other guarantees, were \$6.5 billion at September 30, 1996, compared with \$5.9 billion at December 31, 1995.

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 September 30, 1996 was \$82 million, compared with \$9 million at December 31, 1995. At September 30, 1996 the Corporation had \$6 million pledged collateral to offset credit risk. The exposure to credit losses from interest-rate swaps can be expected to fluctuate significantly due to changes in interest rates.

The Corporation's shareholders' equity at September 30, 1996 was \$12.3 billion, compared with \$11.0 billion at December 31, 1995, and \$10.7 billion at September 30, 1995.

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—Overview" and "—Balance Sheet Analysis—Liquidity and Capital Resources," the Corporation repurchased 7 million shares of common stock at a weighted average cost of \$31.43 per share during the third quarter of 1996. Common stock repurchases during the first nine months of 1996 totaled 47.7 million shares. As of September 30, 1996, there were 1,061 million shares of common stock outstanding. Also as part of the capital restructuring program, on September 20, 1996, the Corporation issued 5.0 million shares of 6.45 percent, noncumulative preferred stock, Series C, with a stated value of \$50 per share, bringing total preferred stock issuances for the year to \$1.0 billion.

On October 15, 1996, the Board of Directors approved a dividend for the quarter ended September 30, 1996 of \$0.19 per common share, and dividends of \$0.80125 per Series A preferred share, \$0.81250 per Series B preferred share, and \$0.90479 per Series C preferred share for the periods from and including September 30, 1996, September 30, 1996, and September 20, 1996, respectively, to but excluding December 31, 1996.

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 September 30, 1996.

### **Mortgage-Backed Securities**

The Corporation issued \$33.8 billion of MBS during the third quarter of 1996, compared with \$34.4 billion in the third quarter of 1995. MBS issued in the first nine months of 1996 totaled \$118.2 billion, compared with \$68.8 billion in the first nine months of 1995. The increase in MBS issuances in 1996 versus 1995 was primarily due to an increase in mortgage origination and refinance activity in a lower interest rate environment and, in part, to lower interest rates prompting a lower percentage of adjustable-rate mortgages to be originated, which many lenders desire to hold in their portfolio.

REMIC issuances were \$3.6 billion in the third quarter of 1996 and \$10.8 billion in the first nine months of 1996, compared with \$0.6 billion and \$5.1 billion, respectively, in the comparable periods for 1995.

The following table summarizes MBS activity for the three-month and nine-month periods ended September 30, 1996 and 1995.

**Summary of MBS Activity**

(Dollars in millions)

	<u>Issued</u>				<u>Outstanding (1)</u>		
	<u>Lender Originated (1)</u>				<u>Lender Risk (2)</u>	<u>Fannie Mae Risk</u>	<u>Total (3)</u>
<u>Three Months Ended September 30,</u>	<u>Lender Risk</u>	<u>Fannie Mae Risk</u>	<u>Fannie Mae Originated</u>	<u>Total</u>			
1996 .....	\$ 3,362	\$ 29,950	\$532	\$ 33,844	\$67,557	\$568,805	\$636,362
1995 .....	2,897	31,501	23	34,421	63,154	496,431	559,585
<u>Nine Months Ended September 30,</u>							
1996 .....	\$ 8,329	\$109,085	\$781	\$118,195			
1995 .....	10,436	57,979	406	68,821			

- (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 \$28.7 billion and \$28.9 billion at September 30, 1996 and 1995, 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 \$92.8 billion and \$59.1 billion at September 30, 1996 and 1995, respectively, of Fannie Mae MBS in portfolio.

**RECENT LEGISLATIVE AND REGULATORY DEVELOPMENTS**

In October 1996, the Corporation submitted comments to the Office of Federal Housing Enterprise Oversight (“OFHEO”) on part one (“Part I”) of OFHEO’s proposed regulations to establish the risk-based capital test for Fannie Mae and Freddie Mac. Part I specifies the “benchmark loss experience” that will be combined with other yet to be determined assumptions and applied each quarter to the Corporation’s book of business to establish credit losses under the risk-based capital standard for the Corporation. Part I also specifies the house price index that OFHEO will use in connection with the risk-based capital standard. See “Recent Legislative and Regulatory Developments” in the August 13, 1996 Supplement to the Information Statement. The Corporation commented that several aspects of the initial proposal require adjustment or amendment, because it does not accurately capture the Corporation’s credit history and derives credit loss rates that are significantly worse than any reasonable representation of Fannie Mae’s and Freddie Mac’s loss experience. Development of the final regulations will likely be an iterative process, and management is optimistic that the final regulations will permit the Corporation to manage its business in a reasonably efficient manner.

## 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 Cash Flows .....	16
Notes to Interim Financial Statements .....	16
Computation of Earnings Per Common Share.....	18

## 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, 1996 and the related condensed statements of income and cash flows for the three-month and nine-month periods ended September 30, 1996 and 1995. 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, 1995 (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, 1996, 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, 1995, 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, 1996

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

	<u>Three Months Ended</u> <u>September 30,</u>		<u>Nine Months Ended</u> <u>September 30,</u>	
	<u>1996</u>	<u>1995</u>	<u>1996</u>	<u>1995</u>
	(Dollars in millions, except per share amounts)			
Interest income .....	\$5,993	\$5,336	\$17,583	\$15,485
Interest expense .....	<u>5,093</u>	<u>4,559</u>	<u>14,914</u>	<u>13,278</u>
Net interest income .....	900	777	2,669	2,207
Guaranty fees .....	303	272	887	806
Miscellaneous income, net .....	20	23	57	82
Provision for losses .....	(50)	(35)	(145)	(105)
Foreclosed property expenses .....	(52)	(46)	(157)	(146)
Administrative expenses .....	<u>(142)</u>	<u>(138)</u>	<u>(415)</u>	<u>(402)</u>
Income before federal income taxes and extraordinary item .....	979	853	2,896	2,442
Provision for federal income taxes .....	<u>(289)</u>	<u>(248)</u>	<u>(855)</u>	<u>(695)</u>
Income before extraordinary item .....	690	605	2,041	1,747
Extraordinary loss—early extinguishment of debt (net of tax effect) .....	—	(8)	(29)	(11)
Net income .....	<u>\$ 690</u>	<u>\$ 597</u>	<u>\$ 2,012</u>	<u>\$ 1,736</u>
Preferred dividends .....	<u>(12)</u>	<u>—</u>	<u>(25)</u>	<u>—</u>
Net income available to common stockholders .....	<u>\$ 678</u>	<u>\$ 597</u>	<u>\$ 1,987</u>	<u>\$ 1,736</u>
Per common share:				
Earnings before extraordinary item .....	\$ .63	\$ .55	\$ 1.86	\$ 1.59
Net earnings .....	.63	.54	1.83	1.58
Cash dividends .....	.19	.17	.57	.51

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

	<u>September 30,</u> <u>1996</u>	<u>December 31,</u> <u>1995</u>
	(Dollars in millions)	
Assets		
Mortgage portfolio, net .....	\$277,016	\$252,588
Investments .....	53,944	57,273
Other assets .....	7,574	6,689
Total assets .....	<u>\$338,534</u>	<u>\$316,550</u>
Liabilities		
Debtures, notes, and bonds, net:		
Due within one year .....	\$151,549	\$146,153
Due after one year .....	167,604	153,021
Other liabilities .....	7,114	6,417
Total liabilities .....	326,267	305,591
Stockholders' equity .....	12,267	10,959
Total liabilities and stockholders' equity .....	<u>\$338,534</u>	<u>\$316,550</u>

See Notes to Interim Financial Statements

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1996	1995	1996	1995
	(Dollars in millions)			
Net cash provided by operating activities . . . . .	\$ 2,034	\$ 2,365	\$ 6,386	\$ 5,376
Cash flows from investing activities:				
Purchases of mortgages . . . . .	(15,885)	(16,267)	(51,143)	(36,776)
Proceeds from sales of mortgages . . . . .	—	78	46	398
Mortgage principal repayments . . . . .	8,183	7,498	27,038	17,212
Net (increase) decrease in investments . . . . .	(4,370)	624	3,328	(1,381)
Net cash used in investing activities . . . . .	(12,072)	(8,067)	(20,731)	(20,547)
Cash flows from financing activities:				
Cash proceeds from issuance of debt . . . . .	176,077	188,013	500,408	565,758
Cash payments to retire debt . . . . .	(166,309)	(183,061)	(483,662)	(549,885)
Other . . . . .	(433)	(197)	(2,059)	(578)
Net cash provided by financing activities . . . . .	9,335	4,755	14,687	15,295
Net (decrease) increase in cash and cash equivalents . . . . .	(703)	(947)	342	124
Cash and cash equivalents at beginning of period	1,363	1,302	318	231
Cash and cash equivalents at end of period . . . . .	\$ 660	\$ 355	\$ 660	\$ 355

**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, 1996 are not necessarily indicative of the results that may be expected for the year ending December 31, 1996. 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 February 22, 1996.



**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, 1996</u> (Dollars in billions)
<b>Commitments to purchase mortgages:</b>	
Mandatory delivery .....	\$ 3.1
Optional delivery (1) .....	1.1
Average net yield on mandatory delivery .....	7.91%
<b>Commitments to issue MBS:</b>	
Mandatory delivery (1) .....	\$ 0.1
Optional delivery (1) .....	9.7
<b>Master commitments:</b>	
Mandatory delivery (2) .....	33.2
Optional delivery .....	41.9

- (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, 1996</u> (Dollars in billions)
MBS(1) .....	\$636.4
<b>Amount for which the Corporation has primary foreclosure loss risk(2):</b>	
Conventional .....	564.8
Government-insured or guaranteed .....	4.0
Credit enhancements .....	3.3
Other guarantees .....	3.0

- (1) Includes \$92.8 billion of MBS held in portfolio.
- (2) The Corporation, however, assumes the ultimate risk of loss on all MBS.

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>1996</b>	<b>1995</b>	<b>1996</b>	<b>1995</b>
	<b>(In millions, except per share data)</b>			
Average common shares outstanding .....	1,064	1,091	1,075	1,091
Effect of common stock equivalents (fully diluted) .....	<u>11</u>	<u>9</u>	<u>11</u>	<u>9</u>
Average shares outstanding .....	<u>1,075</u>	<u>1,100</u>	<u>1,086</u>	<u>1,100</u>
Income before extraordinary item .....	\$ 690	\$ 605	\$2,041	\$1,747
Net income .....	690	597	2,012	1,736
Net income available to common stockholders .....	678	597	1,987	1,736
Earnings per common share before extraordinary item .....	\$ .63	\$ .55	\$ 1.86	\$ 1.59
Net earnings per common share .....	.63	.54	1.83	1.58

**MANAGEMENT**

Franklin D. Raines resigned as Vice-Chairman and as a director of the Corporation effective September 12, 1996 in order to become Director of the Office of Management and Budget.



**FannieMae**