

**Supplement dated August 14, 2001 to
Information Statement dated March 30, 2001**



This Supplement describes the financial condition of the Federal National Mortgage Association (“Fannie Mae”) as of June 30, 2001, and contains unaudited financial information with respect to Fannie Mae for the three months and six months ended June 30, 2001. This Supplement is a supplement to, and should be read in conjunction with, Fannie Mae’s Information Statement dated March 30, 2001 (the “Information Statement”) and the Supplement dated May 15, 2001 thereto (the “May 15 Supplement”). The Information Statement describes the business and operations of Fannie Mae and contains financial data as of December 31, 2000. The May 15 Supplement describes the financial condition of Fannie Mae as of March 31, 2001, and contains unaudited financial information with respect to Fannie Mae for the three months ended March 31, 2001. 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. You may obtain copies of Fannie Mae’s current Information Statement, any supplements thereto and other available information regarding Fannie Mae, including Fannie Mae’s Proxy Statement dated April 2, 2001, without charge from the Office of Investor Relations, Fannie Mae, 3900 Wisconsin Avenue, NW, Washington, D.C. 20016 (telephone: 202/752-7115). The Information Statement and supplements can also be accessed on Fannie Mae’s web site at <http://www.fanniemae.com/investors>.

In connection with offerings of securities, Fannie Mae distributes offering circulars, prospectuses, or other offering documents that describe securities offered, their selling arrangements and other information. Fannie Mae may incorporate this Supplement by reference in one or more other offering documents. 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, NW, Washington, D.C. 20016 (202/752-7000). Its Internal Revenue Service employer identification number is 52-0883107.

Fannie Mae’s securities are not required to be registered under the Securities Act of 1933. At the close of business on July 31, 2001, approximately 1,001 million shares of Fannie Mae’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 Fannie Mae since the date hereof or that the information contained herein is correct as of any time subsequent to its date.

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SELECTED FINANCIAL DATA

The following selected financial data for the three-month and six-month periods ended June 30, 2001 and 2000 are included 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 June 30, 2001 are not necessarily indicative of the results expected for the entire year.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
Operating Data:				
Operating net income(1)	\$ 1,314	\$ 1,097	\$ 2,553	\$ 2,159
Operating earnings per diluted common share	1.27	1.05	2.47	2.08
Total taxable-equivalent revenue(2)	2,448	1,897	4,724	3,789
Average net interest margin	1.09%	1.02%	1.06%	1.02%
Operating return on average realized common equity(3)	25.5	25.4	25.5	25.3
Average effective guaranty fee rate .....	.189	.196	.190	.195
Credit loss ratio(4) .....	.005	.006	.007	.008
Income Statement Data:				
Interest income	\$ 12,218	\$ 10,365	\$ 24,213	\$ 20,338
Interest expense	10,319	8,966	20,606	17,577
Net interest income	1,899	1,399	3,607	2,761
Guaranty fee income	357	339	700	671
Fee and other income (expense)	25	(46)	52	(46)
Credit-related expenses	(17)	(21)	(47)	(51)
Administrative expenses	(254)	(224)	(494)	(441)
Purchased options income (expense)(5)	35	—	(202)	—
Income before federal income taxes, extraordinary item and cumulative effect of change in accounting principle	2,045	1,447	3,616	2,894
Provision for federal income taxes	(550)	(383)	(941)	(768)
Income before extraordinary item and cumulative effect of change in accounting principle ..	1,495	1,064	2,675	2,126
Extraordinary item, gain (loss) on early extinguishment of debt, net of tax effect	(92)	33	(147)	33
Cumulative effect of change in accounting principle, net of tax effect(6)	—	—	168	—
Net income	<u>\$ 1,403</u>	<u>\$ 1,097</u>	<u>\$ 2,696</u>	<u>\$ 2,159</u>
Preferred stock dividends	(35)	(32)	(68)	(52)
Net income available to common shareholders	<u>\$ 1,368</u>	<u>\$ 1,065</u>	<u>\$ 2,628</u>	<u>\$ 2,107</u>
Basic earnings per diluted common share	\$ 1.37	\$ 1.06	\$ 2.63	\$ 2.09
Diluted earnings per common share	1.36	1.05	2.61	2.08
Cash dividends per common share .....	.30	.28	.60	.56
	2001	2000		
Balance Sheet Data at June 30:				
Mortgage portfolio, net	\$662,998	\$549,985		
Liquid assets	59,083	47,424		
Total assets	737,151	608,775		
Borrowings:				
Due within one year	329,159	239,281		
Due after one year	373,175	339,246		
Total liabilities	717,720	589,984		
Stockholders' equity	19,431	18,791		
Core capital(7)	22,978	19,044		
	2001	2000	2001	2000
Other Data:				
Dividend payout ratio	21.9	26.4	22.8	26.9
Ratio of earnings to combined fixed charges and preferred stock dividends(8)	1.19:1	1.16:1	1.17:1	1.16:1
Mortgage purchases	\$ 65,270	\$ 31,971	\$123,997	\$ 61,291
MBS issues acquired by others	100,439	29,989	147,289	51,456
Outstanding MBS at period-end(9)	773,836	696,573	773,836	696,573
Weighted-average diluted common shares outstanding	1,007	1,010	1,007	1,014

(1) Excludes the cumulative after-tax gain of \$168 million from the change in accounting principle upon adoption of SFAS 133 on January 1, 2001 and the net of tax gain of \$24 million recognized during the second quarter of 2001 and the net of tax loss of \$131 million recognized during the first six months of 2001 for the change in fair value of time value of purchased options. Includes after-tax charges of \$65 million and \$106 million, respectively, for the amortization expense of purchased option premiums during the three- and six-month periods ended June 30, 2001.

(2) Includes revenues net of operating losses and amortization expense of purchased option premiums, plus taxable-equivalent adjustments for tax-exempt income and investment tax credits using the applicable federal income tax rate.

(3) Annualized operating net income divided by average realized common stockholders' equity (common stockholders' equity excluding accumulated other comprehensive income).

(4) Charge-offs, net of recoveries, and foreclosed property expenses as a percentage of average net portfolio and average net MBS outstanding (annualized).

(5) The change in the fair value of the time value of purchased options, which includes \$100 million and \$164 million of amortization expense related to purchased option premiums in the second quarter of 2001 and first half of 2001, respectively.

(6) To record the net of tax effect of the adoption of SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*, on January 1, 2001.

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

(8) "Earnings" consists of (i) income before federal income taxes, extraordinary items and cumulative effect of accounting changes and (ii) fixed charges. "Fixed charges" represents interest expense.

(9) MBS held by investors other than Fannie Mae.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE THREE-MONTH AND SIX-MONTH PERIODS ENDED JUNE 30, 2001

Results of Operations

Fannie Mae generated operating net income of \$1.314 billion for the second quarter of 2001, a 20 percent increase over operating net income of \$1.097 billion for the second quarter of 2000. Operating earnings per diluted common share (EPS) grew 21 percent to \$1.27 in the second quarter of 2001 over the same period in 2000. For the first six months of 2001, operating net income grew 18 percent to \$2.553 billion versus the first six months of 2000. Operating EPS increased 19 percent to \$2.47 in the first half of 2001 compared with the same period in 2000. Fannie Mae expects annual operating EPS growth for 2001 to be in the range of the EPS growth rates reported for the second quarter of 2001 (21 percent) and year-to-date 2001 (19 percent). For 2002, management expects operating EPS growth to be consistent with the mid-teens growth rates that have characterized the past several years.

Fannie Mae's operating net income excludes both the one-time, cumulative after-tax gain recorded January 1, 2001 upon the adoption of Financial Accounting Standard No. 133 (FAS 133), *Accounting for Derivative Instruments and Hedging Activities*, and the net of tax impact of the change in fair value of the time value of purchased options associated with FAS 133, and includes an after-tax charge for the amortization expense of purchased option premiums. Net income for the second quarter of 2001 including these items was \$1.403 billion and diluted EPS was \$1.36, compared with net income of \$1.097 billion and diluted EPS of \$1.05 in the second quarter of 2000. Net income for the first half of 2001 including these items was \$2.696 billion and diluted EPS was \$2.61, compared with net income of \$2.159 billion and diluted EPS of \$2.08 in the first half of 2000. The chart below reconciles net income to operating net income for the three-month and six-month periods ending June 30, 2001.

	Three Months Ended June 30, 2001	Six Months Ended June 30, 2001
	(Dollars in millions)	
Net income	\$1,403	\$2,696
Cumulative after-tax gain from adoption of FAS 133	—	(168)
(Gain) loss from change in fair value of time value of purchased options, net of tax	(24)	131
After-tax charge for amortization expense of purchased option premiums	<u>(65)</u>	<u>(106)</u>
Operating net income	<u>\$1,314</u>	<u>\$2,553</u>

The increase in operating net income in both periods resulted primarily from significant growth in taxable-equivalent revenue. Fannie Mae's taxable-equivalent revenue grew 29 percent in the second quarter of 2001 over the second quarter of 2000 to \$2.448 billion and increased 25 percent in the first half of 2001 over the first half of 2000 to \$4.724 billion largely due to growth in net interest income. Taxable-equivalent revenue is total revenue, net of operating losses and amortization expense of purchased option premiums, adjusted to include the full pre-tax value of tax-exempt income and investment tax credits based on applicable federal income tax rates.

Fannie Mae's net interest income, adjusted to include the amortization expense of purchased option premiums, grew 29 percent in the second quarter of 2001 over the prior year period due to a 20 percent increase in the average net investment portfolio and a seven basis point increase in the net interest margin. Adjusted net interest income for the first six months of 2001 grew 25 percent compared with the prior year's period because of a 19 percent increase in the average net investment portfolio and a four basis point increase in the net interest margin. Fannie Mae's adjusted net interest income is a more meaningful measure of portfolio revenue as it is comparable with reported net interest income in prior periods. Prior to the adoption of FAS 133, reported net interest income included the amortization expense of purchased option premiums. With the adoption of FAS 133, this

cost, which totaled \$100 million in the second quarter of 2001 and \$164 million in the first six months of 2001, is now included in the new category “purchased options income (expense)” on the income statement as part of the change in the fair value of the time value of these options.

Management expects that net interest margin should move lower over the next several quarters due to the impact of increased mortgage liquidations and as debt with lower-than-average costs runs off. However, it is likely that Fannie Mae’s net interest margin will remain above its 99 basis point average of the fourth quarter of 2000 throughout much of 2002.

The following table presents an analysis of net interest income and average balances for the three-month and six-month periods ended June 30, 2001 and 2000.

Net Interest Income and Average Balances

(Dollars in millions)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
Interest income:				
Mortgage portfolio	\$ 11,498	\$ 9,569	\$ 22,630	\$ 18,860
Investments and cash equivalents	720	796	1,583	1,478
Total interest income	<u>12,218</u>	<u>10,365</u>	<u>24,213</u>	<u>20,338</u>
Interest expense (1):				
Short-term debt	1,764	955	3,578	1,865
Long-term debt	8,555	8,011	17,028	15,712
Total interest expense	<u>10,319</u>	<u>8,966</u>	<u>20,606</u>	<u>17,577</u>
Net interest income	1,899	1,399	3,607	2,761
Taxable-equivalent adjustment(2)	114	102	225	197
Net interest income taxable-equivalent basis	<u>\$ 2,013</u>	<u>\$ 1,501</u>	<u>\$ 3,832</u>	<u>\$ 2,958</u>
Average balances:				
Interest-earning assets(3):				
Mortgage portfolio, net	\$647,493	\$539,282	\$635,128	\$533,576
Investments and cash equivalents	56,764	49,372	56,243	47,104
Total interest-earning assets	<u>\$704,257</u>	<u>\$588,654</u>	<u>\$691,371</u>	<u>\$580,680</u>
Interest-bearing liabilities(1):				
Short-term debt	\$145,857	\$ 67,621	\$137,907	\$ 68,074
Long-term debt	535,161	500,670	529,797	492,664
Total interest-bearing liabilities	681,018	568,291	667,704	560,738
Interest-free funds	23,239	20,363	23,667	19,942
Total interest-bearing liabilities and interest-free funds	<u>\$704,257</u>	<u>\$588,654</u>	<u>\$691,371</u>	<u>\$580,680</u>
Average interest rates (2):				
Interest-earning assets:				
Mortgage portfolio, net	7.14%	7.13%	7.18%	7.11%
Investments and cash equivalents	5.13	6.50	5.69	6.31
Total interest-earning assets	<u>6.98</u>	<u>7.07</u>	<u>7.06</u>	<u>7.04</u>
Interest-bearing liabilities(1):				
Short-term debt	4.82	5.63	5.16	5.44
Long-term debt (4)	6.47	6.40	6.49	6.38
Total interest-bearing liabilities	<u>6.12</u>	<u>6.31</u>	<u>6.22</u>	<u>6.26</u>
Investment spread(5) .....	.86	.76	.84	.78
Interest-free return(6) .....	.23	.26	.22	.24
Net interest margin(7)	<u>1.09%</u>	<u>1.02%</u>	<u>1.06%</u>	<u>1.02%</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 derivative financial instruments.

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

(3) Includes average balance of nonperforming loans of \$2.3 billion for both the three- and six-month periods ended June 30, 2001, and \$2.2 billion and \$2.3 billion for the three- and six-month periods ended June 30, 2000, respectively.

(4) Includes the amortization expense of purchased option premiums of \$100 million and \$164 million for the three- and six-month periods ended June 30, 2001, respectively.

(5) Consists primarily of the difference between the yield on interest-earning assets, adjusted for tax benefits of nontaxable income, and the effective cost of funds on interest-bearing liabilities.

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

(7) Consists of net interest income on a taxable-equivalent basis, less the amortization expense of purchased option premiums in the three- and six-month periods ended June 30, 2001, 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, 2001 and 2000.

Rate / Volume Analysis
(Dollars in millions)

<u>Second Quarter 2001 vs. Second Quarter 2000</u>	<u>Increase (Decrease)</u>	<u>Attributable to Changes in (1)</u>	
		<u>Volume</u>	<u>Rate</u>
Interest income:			
Mortgage portfolio	\$1,929	\$1,922	\$ 7
Investments and cash equivalents	<u>(76)</u>	<u>109</u>	<u>(185)</u>
Total interest income	<u>1,853</u>	<u>2,031</u>	<u>(178)</u>
Interest expense(2):			
Short-term debt	809	964	(155)
Long-term debt	<u>544</u>	<u>551</u>	<u>(7)</u>
Total interest expense	<u>1,353</u>	<u>1,515</u>	<u>(162)</u>
Net interest income	<u>\$ 500</u>	<u>\$ 516</u>	<u>\$ (16)</u>
<u>First Six Months 2001 vs. First Six Months 2000</u>	<u>Increase (Decrease)</u>	<u>Attributable to Changes in (1)</u>	
		<u>Volume</u>	<u>Rate</u>
Interest income:			
Mortgage portfolio	\$3,770	\$3,617	\$153
Investments and cash equivalents	<u>105</u>	<u>268</u>	<u>(163)</u>
Total interest income	<u>3,875</u>	<u>3,885</u>	<u>(10)</u>
Interest expense(2):			
Short-term debt	1,713	1,817	(104)
Long-term debt	<u>1,316</u>	<u>1,193</u>	<u>123</u>
Total interest expense	<u>3,029</u>	<u>3,010</u>	<u>19</u>
Net interest income	<u>\$ 846</u>	<u>\$ 875</u>	<u>\$ (29)</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.
- (2) Classification of interest expense and interest-bearing liabilities as short-term or long-term is based on the effective maturity or repricing date, taking into consideration the effect of derivative financial instruments.

Guaranty fee income increased by \$18 million, or five percent, to \$357 million, compared with \$339 million in the second quarter of 2000. This increase resulted from a nine percent growth in average outstanding Mortgage-Backed Securities (“MBS”), partially offset by a decline in the effective guaranty fee rate to 18.9 basis points in the second quarter of 2001 from 19.6 basis points in the second quarter of 2000. For the first half of 2001, guaranty fee income increased by \$29 million, or four percent, to \$700 million compared with the first half of 2000. This increase was the result of a seven percent increase in average net MBS outstanding, partially offset by a .5 basis point decrease in the average effective guaranty fee rate. Management expects the effective guaranty fee rate to stabilize as liquidations of older business with relatively high fee rates slow.

Fee and other income (expense) increased \$71 million to \$25 million of income in the second quarter of 2001 compared with \$46 million of expense in the second quarter of 2000. Fee and other income (expense) for the first six months of 2001 grew \$98 million to \$52 million of income, compared with \$46 million of expense for the first half of 2000. Fee and other income (expense) increased, in part, because of growth in transaction fees. In addition, fee and other income (expense) was dampened in the second quarter and first half of 2000 by a hedging loss on a Benchmark Note issuance. Fee and other income (expense) includes technology fees, transaction fees, multifamily fees, as well as other miscellaneous items, and is net of operating losses from certain tax-advantaged investments.

Administrative expenses in the second quarter of 2001 increased \$30 million, or 13 percent, over the second quarter of 2000 to \$254 million primarily due to increased compensation costs. Fannie Mae's efficiency ratio (ratio of administrative expenses to taxable-equivalent revenue) improved to 10.4 percent for the second quarter of 2001 from 11.8 percent for the second quarter of 2000. For the first half of 2001, administrative expenses grew 12 percent to \$494 million, compared with the same period in 2000. Fannie Mae's efficiency ratio decreased to 10.5 percent for the first half of 2001, from 11.6 percent for the first half of 2000. Fannie Mae's ratio of annualized administrative expenses to the average mortgage portfolio plus average MBS outstanding (combined book of business) remained stable at .073 percent and .072 percent for the three- and six-month periods ended June 30, 2001, compared with the prior year's periods.

During the three- and six-month periods ended June 30, 2001, Fannie Mae recorded \$35 million in purchased options income and \$202 million in purchased options expense, respectively. Purchased options income (expense) represents the change in the fair value of the time value of purchased options during the reporting period. Included in purchased options expense is \$100 million and \$164 million in amortization expense of purchased option premiums for the three- and six-month periods ended June 30, 2001, respectively, that would have been reported in net interest income prior to the adoption of FAS 133. The change in the fair value of the time value of purchased options will vary from period to period; however, the net expense included in earnings from the purchase date until the exercise date of an option will equal the option premium paid.

Federal income tax expense, including the tax impact from extraordinary items, increased \$99 million to \$500 million in the second quarter of 2001 from \$401 million in the second quarter of 2000. Federal income tax expense, including the tax effect from extraordinary items, increased \$167 million to \$952 million in the first half of 2001 from \$785 million in the first half of 2000. The effective federal income tax rate on operating income decreased to 26 percent for the second quarter and first half of 2001 from 27 percent for the second quarter and first half of 2000. The effective federal income tax rate on operating income is federal income tax expense (including the tax impact from extraordinary items) divided by operating income. Operating income is income before taxes and extraordinary items, excluding purchased options income (expense) and including the amortization expense of purchased option premiums.

Fannie Mae incurred extraordinary losses of \$143 million (\$92 million after-tax) from the call or repurchase of debt in the second quarter of 2001, compared with extraordinary gains of \$50 million (\$33 million after-tax) from the call or repurchase of debt in the second quarter of 2000. Debt called or repurchased in the second quarter of 2001 totaled \$36 billion, compared with \$1 billion in the second quarter of 2000 and \$18 billion for all of 2000. Fannie Mae incurred extraordinary losses of \$226 million (\$147 million after-tax) from the call or repurchase of debt in the first half of 2001, compared with extraordinary gains of \$50 million (\$33 million after-tax) from the call or repurchase of debt in the first half of 2000. Fannie Mae called or repurchased \$115 billion of debt in the first half of 2001, compared with \$3 billion in the first half of 2000 because of a sharp decline in short- and immediate-term debt costs.

Fannie Mae's adoption of FAS 133 resulted in cumulative pre-tax income of \$258 million (\$168 million after-tax) in the first quarter of 2001 from the change in accounting principle. The

cumulative effect on earnings from the change in accounting principle is attributable to recording the fair value of the time value of purchased options that the company used as a substitute for callable debt at adoption of FAS 133 on January 1, 2001.

Risk Management

Fannie Mae is subject to several major areas of risk, including interest rate risk and credit risk, that are described and discussed in the Information Statement under “Recent Developments” and “MD&A — Risk Management.”

Interest Rate Risk Management

Two primary measures of interest rate risk used by Fannie Mae to manage its mortgage portfolio business are net interest income at risk and portfolio duration gap.

Fannie Mae’s net interest income at risk measures the sensitivity of Fannie Mae’s projected net interest income to an immediate 50 basis point increase or decrease in interest rates and an immediate 25 basis point increase or decrease in the slope of the yield curve. Yield curve slope sensitivity is calculated assuming a 25 basis point flattening or steepening between one and ten-year maturities, with the five-year yield held constant. Net interest income at risk expresses the percentage change in projected net interest income under the more adverse interest rate and yield curve scenarios. Over the company’s monthly reporting period, a 50 basis point change in interest rates and a 25 basis point change in the slope of the yield curve encompass approximately 95 percent of the actual changes that are likely to occur. Fannie Mae’s net interest income at risk over a one-year and four-year period under each of the interest rate scenarios were as follows at June 30, 2001:

	Assuming a 50 basis point change in interest rates		Assuming a 25 basis point change in slope of yield curve	
	One-year	Four-year	One-year	Four-year
June 2001	1.7%	4.4%	0.9%	2.0%

The net interest income at risk results were within Fannie Mae’s expected range of 1 percent to 5 percent. A positive number indicates the percent by which projected net interest income could be reduced by the increased rate shock. Actual portfolio net interest income may differ from these estimates because of specific interest rate movements, changing business conditions, changing prepayments, and management actions.

The portfolio duration gap—the difference between the durations of portfolio assets and liabilities—summarizes for management the extent to which estimated cash flows for assets and liabilities are matched, on average, through time and across interest rate scenarios. A positive duration gap indicates more of an exposure to rising interest rates, and a negative duration gap indicates more of an exposure to declining interest rates. In computing duration gap, Fannie Mae uses a modified option-adjusted duration calculation. Fannie Mae’s effective duration gap was positive five months at June 30, 2001, compared to negative three months at December 31, 2000 and positive four months at June 30, 2000. Fannie Mae’s duration gap target range is plus or minus six months.

Credit Risk Management

The following table shows Fannie Mae’s serious delinquencies for conventional loans in portfolio and underlying MBS, the number of conventional properties acquired, and total net charge-offs (recoveries) for the three- and six-month periods ended June 30, 2001 and 2000.

	Delinquency Rate (1)		Number of Properties Acquired				Net Charge-offs / (Recoveries) (Dollars in millions)			
			Three Months Ended June 30,		Six Months Ended June 30,		Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000	2001	2000	2001	2000	2001	2000
Single-family .....	.43%	.41%	3,566	3,649	7,159	7,602	\$(31)	\$(32)	\$(57)	\$(65)
Multifamily .....	.07	.05	—	—	1	1	—	—	—	1
Total							<u>\$(31)</u>	<u>\$(32)</u>	<u>\$(57)</u>	<u>\$(64)</u>

(1) Single-family serious delinquencies consist of those loans in the portfolio or underlying MBS for which Fannie Mae 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 Fannie Mae 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, decreased \$2 million to \$16 million in the second quarter of 2001 from the second quarter of 2000 and decreased \$2 million to \$45 million in the first six months of 2001 from the first six months of 2000 due to a decline in foreclosed property expenses. Fannie Mae's credit loss ratio—credit-related losses as a percentage of the average combined book of business—decreased to .5 basis points in the second quarter of 2001 from .6 basis points in the second quarter of 2000, and decreased to .7 basis points in the first six months of 2001 from .8 basis points in the first six months of 2000. While credit-related losses might be at or near their low point, any near-term increases in credit-related losses likely would be small, and have little perceptible effect on Fannie Mae's net income growth.

The inventory of single-family properties held by Fannie Mae declined to 6,458 as of June 30, 2001 from 6,785 as of June 30, 2000. The inventory of multifamily properties was 2 on both June 30, 2001 and June 30, 2000.

Total credit-related expenses, which include foreclosed property expenses and the provision for losses, decreased \$4 million to \$17 million in the second quarter of 2001 from the second quarter of 2000 and decreased \$4 million to \$47 million in the first six months of 2001 from the first six months of 2000 due to a decline in foreclosed property expenses.

The allowance for losses increased to \$811 million at June 30, 2001 from \$809 million at December 31, 2000. The allowance for losses declined as a percentage of Fannie Mae's total book of business to .056 percent at June 30, 2001 from .062 percent at December 31, 2000. Nonperforming loans outstanding totaled \$2.3 billion at June 30, 2001, compared with \$1.9 billion at December 31, 2000.

The use of credit enhancement contracts is an important tool to provide protection against credit losses. These contracts include primary loan-level mortgage insurance, pool mortgage insurance, recourse arrangements with lenders, and customized contracts. Fannie Mae's credit risk in these contracts is that counterparties will not fulfill their contractual obligations to make payments due to Fannie Mae. At June 30, 2001, Fannie Mae was the beneficiary on primary mortgage insurance coverage of \$305 billion for single-family loans in portfolio or underlying MBS. Seven mortgage insurance companies, all rated AA or higher by Standard & Poor's, provided 96 percent of this coverage. At June 30, 2001, Fannie Mae held an estimated \$35 billion in total recourse to lenders on single-family loans and 67 percent of the recourse providers were rated investment grade or higher (a rating of BBB-/Baa- or higher by Standard & Poor's and Moody's Investor Service, respectively). The recourse providers that were not investment grade or were not rated constituted 33 percent of Fannie Mae's single-family recourse exposure. Fannie Mae mitigates the risk associated with recourse

transactions through various means, including requiring lenders to pledge collateral to secure their obligations.

Fannie Mae also has counterparty performance risk in its derivatives and liquidity investments. Credit risk information related to derivatives and liquidity investments is provided under “Balance Sheet Analysis—Financing and Other Activities” and “Balance Sheet Analysis—Investments,” respectively.

Balance Sheet Analysis

Mortgage Portfolio

As of June 30, 2001, the net mortgage portfolio totaled \$663 billion with an average yield (before deducting the allowance for losses) of 7.12 percent, compared with \$607 billion with an average yield of 7.24 percent as of December 31, 2000 and \$550 billion with an average yield of 7.15 percent as of June 30, 2000. The decline in the net mortgage portfolio yield from December 31, 2000 to June 30, 2001 was primarily due to a decrease in interest rates as conventional mortgage purchase yields fell and prepayments accelerated on mortgages with higher yields.

Fannie Mae purchased \$65 billion of mortgages at an average yield of 6.76 percent in the second quarter of 2001, up from \$32 billion of mortgage purchases at an average yield of 7.62 percent in the second quarter of 2000. During the first six months of 2001, mortgage purchases were \$124 billion at an average yield of 6.81 percent, up from purchases of \$61 billion at an average yield of 7.64 percent for the first six months of 2000. The increase in mortgage purchases in both periods was primarily due to a lower interest rate environment and the increased availability of mortgages offered for sale in the secondary market.

Mortgage loan repayments increased during the second quarter of 2001 to \$41 billion from \$14 billion in the second quarter of 2000. During the first half of 2001, mortgage loan repayments increased to \$64 billion from \$25 billion in the first half of 2000. The increase in loan repayments was primarily due to an increased level of refinance activity in a lower interest rate environment.

Mandatory commitments issued to purchase mortgages from lenders, net of commitments to sell mortgages, increased to \$66 billion during the second quarter 2001, up from \$31 billion during the second quarter of 2000. At June 30, 2001, Fannie Mae’s outstanding mandatory delivery commitments to purchase mortgages increased to \$38 billion versus \$16 billion of such commitments at December 31, 2000 and \$9 billion at June 30, 2000. As the outstanding mandatory delivery commitments to purchase mortgages settle in the third quarter, mortgage portfolio growth is expected to accelerate from its second quarter pace. All of the above factors contribute to management’s expectation of high-teens mortgage portfolio growth in 2001.

Investments

Presented below are the amortized cost and fair value of the Liquid Investment Portfolio and other investments classified as held-to-maturity and available-for sale at June 30, 2001 and December 31, 2000.

(Dollars in millions)	June 30, 2001				December 31, 2000			
	Amortized Cost	Fair Value	Average Maturity in Months	% Rated A or Better	Amortized Cost	Fair Value	Average Maturity in Months	% Rated A or Better
Held-to-maturity investments:								
Asset-backed securities	\$ 6,407	\$ 6,463	18.9	100.0%	\$ 9,043	\$ 9,066	22.6	100.0%
Federal funds	2,796	2,796	0.9	100.0	3,493	3,493	2.1	100.0
Repurchase agreements	7,435	7,435	0.5	100.0	2,722	2,722	0.5	100.0
Commercial paper	1,929	1,929	0.4	100.0	8,893	8,895	0.7	90.1
Auction rate preferred stock	2,208	2,208	2.0	100.0	1,812	1,812	1.9	98.6
Eurodollar time deposits . . .	2,475	2,475	0.8	100.0	4,046	4,046	1.2	100.0
Other	5,450	5,520	9.5	100.0	3,823	3,852	17.6	100.0
Total	<u>\$28,700</u>	<u>\$28,826</u>	<u>6.5</u>	<u>100.0%</u>	<u>\$33,832</u>	<u>\$33,886</u>	<u>8.7</u>	<u>97.3%</u>

(Dollars in millions)	June 30, 2001				December 31, 2000			
	Amortized Cost	Fair Value	Average Maturity in Months	% Rated A or Better	Amortized Cost	Fair Value	Average Maturity in Months	% Rated A or Better
Available-for-sale investments:								
Asset-backed securities(1)	\$12,980	\$12,983	43.0	100.0%	\$ 8,469	\$ 8,469	49.6	100.0%
Floating rate notes(1)	13,529	13,529	18.9	95.5	12,237	12,224	18.5	99.7
Other	3,047	3,047	1.0	100.0	443	443	0.6	100.0
Total	<u>\$29,556</u>	<u>\$29,559</u>	<u>27.6</u>	<u>97.9%</u>	<u>\$21,149</u>	<u>\$21,136</u>	<u>30.6</u>	<u>99.8%</u>

(1) As of June 30, 2001, 100 percent of asset-backed securities and floating rate notes reprice at intervals of 90 days or less.

The primary credit risk associated with investment securities is that issuers will not repay Fannie Mae in accordance with contractual terms. The level of credit risk in the portfolio is low because these investments are primarily high-quality, short-term securities. At June 30, 2001, 99 percent of the Liquid Investment Portfolio and other investments had a credit rating of A or higher. At December 31, 2000, 98 percent of the Liquid Investment Portfolio and other investments had a credit rating of A or higher.

The following table shows the amortized cost, fair value, and yield of the Liquid Investment Portfolio and other investments at June 30, 2001 and December 31, 2000 by remaining maturity.

(Dollars in millions)	June 30, 2001			December 31, 2000		
	Amortized Cost	Fair Value	Yield	Amortized Cost	Fair Value	Yield
Due within 1 year	\$26,172	\$26,173	4.34%	\$27,026	\$27,010	6.85%
Due after one year through five years . . .	12,697	12,766	5.01	10,443	10,477	7.12
	38,869	38,939	4.56	37,469	37,487	6.93
Asset-backed securities(1)	19,387	19,446	5.00	17,512	17,535	6.84
	<u>\$58,256</u>	<u>\$58,385</u>	<u>4.71%</u>	<u>\$54,981</u>	<u>\$55,022</u>	<u>6.90%</u>

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

Financing and Other Activities

Fannie Mae's total debt outstanding increased 21 percent to \$702 billion at June 30, 2001 from \$579 billion at June 30, 2000. The cost of debt outstanding at June 30, 2001 decreased to 6.03 percent from 6.47 percent at December 31, 2000 and 6.38 percent at June 30, 2000. Fannie Mae's financing activities for the first half of 2001 and 2000 are summarized below.

<u>(Dollars in billions)</u>	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
Debt issued	\$ 462	\$ 291	\$ 904	\$ 643
Average cost	4.56%	6.48%	4.99%	6.15%
Debt redeemed	\$ 427	\$ 270	\$ 845	\$ 611
Average cost	4.97%	6.12%	5.52%	5.87%

Fannie Mae called a large amount of higher cost debt in the first half of 2001 because of a sharp decline in short- and immediate-term interest rates, and Fannie Mae replaced a portion of that debt in shorter maturities pending an anticipated rise in mortgage loan liquidations. As a result, the amount of option-embedded debt instruments as a percentage of the net mortgage portfolio was lower at June 30, 2001 than the amount at June 30, 2000. The following table presents the amount of option-embedded debt instruments as a percentage of mortgage purchases and the net mortgage portfolio at June 30, 2001 and June 30, 2000. Option-embedded debt instruments include the effect of derivative financial instruments.

<u>(Dollars in billions)</u>	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
Issued during the period	\$ 76	\$ 19	\$133	\$ 33
Percentage of total mortgage purchases	117%	59%	108%	53%
Outstanding at end of period	\$296	\$272	\$296	\$272
Percentage of total net mortgage portfolio	45%	49%	45%	49%

The following table summarizes certain of Fannie Mae's derivative financial instrument activities for the quarter ended June 30, 2001, the balances as of June 30, 2001 and 2000, and the expected maturities of the derivative instruments outstanding as of June 30, 2001.

Derivative Financial Instruments Table (1)

(Dollars in millions)

	Generic-Pay Fixed/ Receive Variable Swaps (2)			Pay Variable/ Receive Fixed Swaps	Basis Swaps	Caps and Swaptions (4)	Total
	Notional	Pay Rate (3)	Receive Rate (3)				
Balance at March 31, 2001	\$166,587	6.62%	5.79%	\$54,352	\$19,909	\$108,578	\$349,426
Additions	38,982	5.50	4.30	5,951	15,765	52,550	113,248
Maturities	<u>6,375</u>	6.77	5.11	<u>9,485</u>	<u>5,900</u>	<u>4,970</u>	<u>26,730</u>
Balance at June 30, 2001	<u>\$199,194</u>	6.39%	4.54%	<u>\$50,818</u>	<u>\$29,774</u>	<u>\$156,158</u>	<u>\$435,944</u>
Balance at June 30, 2000	<u>\$146,229</u>	6.60%	6.59%	<u>\$35,688</u>	<u>\$24,844</u>	<u>\$ 71,065</u>	<u>\$277,826</u>
Future Maturities ⁽⁵⁾							
2001	\$ 7,625	6.10%	4.65%	\$25,951	\$ 7,000	\$ 11,300	\$ 51,876
2002	26,545	5.53	4.81	10,175	19,794	34,350	90,864
2003	19,575	5.57	4.53	3,232	2,500	26,708	52,015
2004	14,320	6.66	4.44	1,475	250	6,450	22,495
2005	15,425	6.56	4.57	700	230	5,200	21,555
Thereafter	<u>115,704</u>	6.69	4.47	<u>9,285</u>	<u>0</u>	<u>72,150</u>	<u>197,139</u>
	<u>\$199,194</u>	6.39%	4.54%	<u>\$50,818</u>	<u>\$29,774</u>	<u>\$156,158</u>	<u>\$435,944</u>

- (1) Dollars represent notional amounts that only indicate the amount on which payments are being calculated and do not represent the risk of loss.
- (2) Included in the notional amounts are callable swaps of \$31 billion, \$34 billion, and \$35 billion with weighted-average pay rates of 6.64 percent, 6.67 percent and 6.65 percent and weighted-average receive rates of 4.63 percent, 5.70 percent, and 6.56 percent at June 30, 2001, March 31, 2001 and June 30, 2000, respectively.
- (3) The weighted-average rate payable and receivable is as of the date indicated. As the rates of the swaps may be floating, these rates may change as prevailing interest rates change.
- (4) The notional amounts of caps and swaptions were \$59 billion and \$97 billion at June 30, 2001, respectively, and \$28 billion and \$43 billion at June 30, 2000, respectively.
- (5) Based on stated maturities. Assumes that variable rates remain constant at June 30, 2001 levels.

The notional amount of other derivative financial instruments, which includes foreign currency swaps, futures contracts, and derivative instruments that simulate short sales of U.S. Treasury and agency securities to provide a hedge against interest rate fluctuations, totaled \$14 billion at June 30, 2001.

The primary credit risk posed by Fannie Mae's derivative transactions is that a counterparty might default on its payments to Fannie Mae, which could result in Fannie Mae having to replace derivatives with a different counterparty at a higher cost. Fannie Mae reduces credit risk on derivatives by dealing only with experienced counterparties of high credit quality, diversifying these derivative instruments across counterparties, ensuring that these derivative instruments generally are executed under master agreements that provide for netting of certain amounts payable by each party, and retaining collateral if credit loss exposure to a counterparty exceeds an agreed-upon threshold.

Fannie Mae regularly monitors the exposures on its derivative instruments by valuing the positions via dealer quotes and internal pricing models. The exposure to credit loss for derivative instruments can be estimated by calculating the cost, on a present value basis, to replace at current market rates all those derivative instruments outstanding for which Fannie Mae was in a gain

position. Fannie Mae's gross exposure (taking into account master settlement agreements, but not collateral received) was \$419 million at June 30, 2001 and \$182 million at December 31, 2000. Fannie Mae expects the credit exposure to fluctuate as interest rates change.

Counterparties are obligated to post collateral if Fannie Mae is exposed to credit loss on the related derivative instruments exceeding an agreed-upon threshold. The amount of required collateral is based on counterparty credit ratings and the level of credit exposure. Fannie Mae generally requires overcollateralization from counterparties whose credit ratings have dropped below predetermined levels. Fannie Mae held \$277 million of collateral through custodians for derivative instruments at June 30, 2001 and \$70 million at December 31, 2000.

At June 30, 2001, over 99 percent of both the notional amount of Fannie Mae's outstanding derivative transactions and Fannie Mae's exposure on derivatives in a gain position were with counterparties rated A or better by Standard & Poor's. At June 30, 2001, eight counterparties represented approximately 83 percent of the total notional amount of outstanding derivative transactions, and each had a credit rating of A or better. At June 30, 2001, five counterparties comprised approximately 97 percent of gross exposure on derivatives in a gain position, and each had a credit rating of A or better.

Capital Resources & Liquidity

Fannie Mae's core capital (defined as the stated value of outstanding common stock, the stated value of outstanding noncumulative perpetual preferred stock, paid-in capital, and retained earnings) increased to \$23.0 billion at June 30, 2001 from \$20.8 billion at December 31, 2000 and \$19.0 billion at June 30, 2000. Fannie Mae's core capital, which excludes accumulated other comprehensive income (AOCI), is a more accurate reflection of its capital resources than total stockholders' equity. AOCI is excluded from core capital because AOCI includes unrealized gains (losses) on derivatives and investment securities but does not include the related unrealized losses (gains) on items hedged by these derivatives nor the liabilities that fund the acquisition of investment securities.

At June 30, 2001, AOCI totaled negative \$3.5 billion, compared with a positive balance of \$10 million at December 31, 2000 and negative \$253 million at June 30, 2000. Upon adoption of FAS 133 on January 1, 2001, Fannie Mae recorded a \$3.9 billion reduction in AOCI. The \$3.9 billion reduction in AOCI was attributable primarily to recording derivatives, mostly interest rate swaps used as substitutes for non-callable debt, that qualify as cash flow hedges on the balance sheet at their fair values. FAS 133 requires that entities mark-to-market derivatives that qualify as cash flow hedges through AOCI to the extent they are effective, but not the hedged items. Subsequent changes in the fair value of derivatives in cash flow hedges will be offset in earnings by interest expense associated with the hedged items to the extent that the hedges are effective.

Fannie Mae had approximately 1,001 million common shares outstanding as of June 30, 2001, compared with 999 million common shares outstanding as of December 31, 2000. Pursuant, in part, to the capital restructuring program described in the Information Statement under "MD&A—Balance Sheet Analysis—Liquidity and Capital Resources," Fannie Mae issued .7 million common shares for employee and other stock compensation plans during the second quarter of 2001.

On April 6, 2001, Fannie Mae issued 8.0 million shares of 5.81 percent noncumulative preferred stock, Series H, with a stated value of \$50 per share, redeemable on or after April 6, 2006. On July 17, 2001, the Board of Directors approved a dividend for the quarter ended June 30, 2001 of \$.30 per common share; dividends of \$.81250 per Series B preferred share, \$.80625 per Series C preferred share, \$.65625 per Series D preferred share, \$.63750 per Series E preferred share, \$.7869 per Series F preferred share, \$.7529 per Series G preferred share, and \$.7263 per Series H preferred share for the period from and including June 30, 2001, to but excluding September 30, 2001.

Fannie Mae issued \$1.0 billion of subordinated debt on August 1, 2001 and \$1.5 billion of subordinated debt on May 8, 2001 that received ratings of Aa2 from Moody's Investors Service and

AA— from Standard & Poor’s. Subordinated debt serves as an important supplement to Fannie Mae’s equity capital, although it is not a component of core capital. Over the next three years, Fannie Mae intends to issue sufficient subordinated debt to bring the sum of total capital and outstanding subordinated debt to at least 4 percent of on-balance-sheet assets, after adjusting for capital required to support the off-balance-sheet mortgage securities business.

As discussed in the Information Statement under “Government Regulation and Charter Act” and “MD&A—Balance Sheet Analysis—Regulatory Environment,” Fannie Mae is subject to capital standards. Fannie Mae met the applicable capital standards as of June 30, 2001, and management expects to continue to comply with the applicable standards.

As part of its voluntary adoption of measures to enhance disclosure, capital, and market discipline, Fannie Mae agreed to maintain more than three months worth of liquidity, assuming no access to the new issue debt markets, to reduce the possibility that the company’s operations could be disrupted during a significant financial crisis. Fannie Mae has a contingency plan in place to ensure funding needs are met for three months without access to the agency debt markets. Fannie Mae also committed to maintain at least five percent of on-balance-sheet assets in a liquid, marketable portfolio of nonmortgage securities and to maintain additional highly liquid securities in unencumbered form to facilitate liquidity. Fannie Mae’s liquid investments were 8.0 percent of Fannie Mae’s on-balance-sheet assets at June 30, 2001.

Mortgage-Backed Securities

Fannie Mae issued \$143 billion of MBS during the second quarter of 2001, an increase from \$49 billion issued in the second quarter of 2000. MBS issued for the first six months of 2001 totaled \$227 billion, up from \$88 billion in the first six months of 2000. The increase in MBS issued in both periods was due to a decrease in interest rates and an increase in mortgage originations. REMIC issuances were \$13 billion in the second quarter of 2001 and \$22 billion in the first six months of 2001, compared with \$7 billion and \$15 billion, respectively, for the comparable periods of 2000.

The following table summarizes MBS activity for the three and six-month periods ended June 30, 2001 and 2000.

Summary of MBS Activity

(Dollars in millions)

<u>Three Months Ended June 30,</u>	<u>Issued (1)</u>			<u>Total MBS Outstanding (1)</u>		
	<u>Lender or Shared Risk</u>	<u>Fannie Mae Risk</u>	<u>Total</u>	<u>Lender or Shared Risk (2)</u>	<u>Fannie Mae Risk</u>	<u>Total (3)</u>
2001	\$12,095	\$131,265	\$143,360	\$210,654	\$953,324	\$1,163,978
2000	6,546	42,040	48,586	214,447	781,368	995,815
<u>Six Months Ended June 30,</u>						
2001	\$16,376	\$210,289	\$226,665			
2000	11,799	75,754	87,553			

- (1) Includes MBS held by Fannie Mae and investors other than Fannie Mae. This table classifies lender originated issued and total MBS based on primary default risk category; however, Fannie Mae bears the ultimate risk of default on all MBS. Total MBS includes MBS that have been pooled to back Megas, SMBS, or REMICs.
- (2) Included in lender or shared risk are \$163 billion and \$168 billion at June 30, 2001 and 2000, 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 \$390 billion and \$299 billion at June 30, 2001 and 2000, respectively, of Fannie Mae MBS held in portfolio.

The decline in the proportion of lender or shared risk on lender originated issues was primarily the result of a decline in the number of loans backing MBS that are covered by lender-acquired pool insurance.

RECENT REGULATORY DEVELOPMENTS

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the "1992 Act") established risk-based capital requirements for Fannie Mae. The 1992 Act also requires the Office of Federal Housing Enterprise Oversight ("OFHEO") to adopt regulations establishing a risk-based capital test to determine the amount of total capital Fannie Mae must hold under the risk-based capital standard on a quarterly basis. (See the "Information Statement dated March 31, 2001 — Government Regulation and Charter Act.") On July 19, 2001, OFHEO announced that the risk-based capital rule would be published in the Federal Register in approximately 45 days. Under the 1992 Act, the final regulations will be enforceable one year after publication in the Federal Register. While the regulations will not be enforceable until the second half of 2002, OFHEO indicated that it will review fourth quarter 2001 data and announce in 2002 whether Fannie Mae's capital position is in line with the new capital standard for the preceding quarter. Management is currently reviewing and analyzing the 550 page rule and will work with OFHEO to see that the rule can be implemented efficiently and effectively.

MATTERS SUBMITTED TO STOCKHOLDERS

At the 2001 Annual Meeting of Stockholders of Fannie Mae held on May 22, 2001, 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 Fannie Mae; (ii) ratification of the appointment of KPMG LLP as auditors of Fannie Mae for 2001; and (iii) a stockholder proposal to reinstate cumulative voting for directors. 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 1,000,625,902 shares of common stock outstanding on the record date for the meeting, 844,575,382 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 (837,463,452 votes for; 7,111,930 votes withheld); Kenneth M. Duberstein (827,897,742 votes for; 16,677,640 votes withheld); Stephen Friedman (837,463,306 votes for; 7,112,076 votes withheld); Thomas P. Gerrity (835,012,021 votes for; 9,563,361 votes withheld); Jamie S. Gorelick (833,431,910 votes for; 11,143,472 votes withheld); Vincent A. Mai (837,459,588 votes for; 7,115,794 votes withheld); Donald B. Marron (837,251,633 votes for; 7,323,749 votes withheld); Ann McLaughlin Korologos (834,428,478 votes for; 10,146,904 votes withheld); Daniel H. Mudd (833,472,379 votes for; 11,103,003 votes withheld); Anne M. Mulcahy (837,108,670 votes for; 7,466,712 votes withheld); Joe K. Pickett (828,014,559 votes for; 16,560,823 votes withheld); Franklin D. Raines (833,508,124 votes for; 11,067,258 votes withheld); H. Patrick Swygert (833,174,523 votes for; 11,400,859 votes withheld).

As noted under "Management," the President of the United States has the authority to appoint five directors.

The ratification of KPMG LLP as auditors was approved by a vote of 803,260,341 for ratification and 38,205,420 against ratification. The stockholder proposal to reinstate cumulative voting was defeated by a vote of 153,725,965 for the proposal and 585,594,017 against the proposal.

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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, 2001 and the related condensed statements of income, changes in stockholders' equity, and cash flows for the three- and six-month periods ended June 30, 2001 and 2000. 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 auditing standards generally accepted in the United States of America, 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 on 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 accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the balance sheet of Fannie Mae as of December 31, 2000 (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 11, 2001, 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, 2000, is fairly stated, in all material respects, in relation to the balance sheet from which it has been derived.

KPMG LLP

Washington, D.C.
July 16, 2001

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
	(Dollars in millions, except per common share amounts)			
Interest income	\$12,218	\$10,365	\$24,213	\$20,338
Interest expense	10,319	8,966	20,606	17,577
Net interest income	1,899	1,399	3,607	2,761
Guaranty fee income	357	339	700	671
Fee and other income (expense)	25	(46)	52	(46)
Credit-related expenses	(17)	(21)	(47)	(51)
Administrative expenses	(254)	(224)	(494)	(441)
Purchased options income (expense)	35	—	(202)	—
Income before federal income taxes, extraordinary item and cumulative effect of change in accounting principle	2,045	1,447	3,616	2,894
Provision for federal income taxes	(550)	(383)	(941)	(768)
Income before extraordinary item and cumulative effect of change in accounting principle	1,495	1,064	2,675	2,126
Extraordinary item— gain (loss) on early extinguishment of debt, net of tax effect	(92)	33	(147)	33
Cumulative effect of change in accounting principle, net of tax effect	—	—	168	—
Net income	<u>\$ 1,403</u>	<u>\$ 1,097</u>	<u>\$ 2,696</u>	<u>\$ 2,159</u>
Preferred stock dividends	(35)	(32)	(68)	(52)
Net income available to common stockholders	<u>\$ 1,368</u>	<u>\$ 1,065</u>	<u>\$ 2,628</u>	<u>\$ 2,107</u>
Basic earnings per common share:				
Earnings before extraordinary item and cumulative effect of change in accounting principle	\$ 1.46	\$ 1.03	\$ 2.61	\$ 2.06
Extraordinary gain (loss)	(.09)	.03	(.15)	.03
Cumulative effect of change in accounting principle	—	—	.17	—
Net earnings	<u>\$ 1.37</u>	<u>\$ 1.06</u>	<u>\$ 2.63</u>	<u>\$ 2.09</u>
Diluted earnings per common share:				
Earnings before extraordinary item and cumulative effect of change in accounting principle	1.45	\$ 1.02	\$ 2.59	\$ 2.05
Extraordinary gain (loss)	(.09)	.03	(.15)	.03
Cumulative effect of change in accounting principle	—	—	.17	—
Net earnings	<u>\$ 1.36</u>	<u>\$ 1.05</u>	<u>\$ 2.61</u>	<u>\$ 2.08</u>

CONDENSED BALANCE SHEETS
(Unaudited)

	June 30, 2001	December 31, 2000
	(Dollars in millions)	
Assets		
Mortgage portfolio, net	\$662,998	\$607,399
Investments	58,259	54,968
Other assets	14,823	12,705
Derivatives in gain positions	1,071	—
Total assets	<u>\$737,151</u>	<u>\$675,072</u>
Liabilities		
Debentures, notes, and bonds, net:		
Due within one year	\$329,159	\$280,322
Due after one year	373,175	362,360
Other liabilities	11,547	11,552
Derivatives in loss positions	3,839	—
Total liabilities	<u>717,720</u>	<u>654,234</u>
Stockholders' equity		
Accumulated other comprehensive income (loss)	(3,547)	10
Core capital	22,978	20,828
Total stockholders' equity	<u>19,431</u>	<u>20,838</u>
Total liabilities and stockholders' equity	<u>\$737,151</u>	<u>\$675,072</u>

See Notes to Interim Financial Statements

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

	<u>Three Months</u> <u>Ended June 30,</u>		<u>Six Months</u> <u>Ended June 30,</u>	
	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
	(Dollars in millions)			
Balance, beginning of period	\$16,086	\$18,371	\$20,838	\$17,629
Comprehensive income:				
Net income	1,403	1,097	2,696	2,159
Other comprehensive income, net of tax effect:				
Transition adjustment from the adoption of FAS 133	—	—	(3,973)	—
Unrealized gain on securities transferred to available- for-sale upon adoption of FAS 133	—	—	86	—
Cash flow hedging gains, net	1,999	—	273	—
Unrealized gains/(losses) on securities, net	(150)	13	57	(7)
Total comprehensive income	<u>3,252</u>	<u>1,110</u>	<u>(861)</u>	<u>2,152</u>
Dividends	(335)	(314)	(668)	(618)
Shares repurchased	—	(403)	(77)	(1,119)
Preferred stock issued	395	—	20	683
Treasury stock issued for stock options and benefit plans	33	27	179	64
Balance, end of period	<u>\$19,431</u>	<u>\$18,791</u>	<u>\$19,431</u>	<u>\$18,791</u>

CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

	<u>Three Months</u> <u>Ended June 30,</u>		<u>Six Months</u> <u>Ended June 30,</u>	
	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
	(Dollars in millions)			
Net cash provided by operating activities	\$ 3,025	\$ 3,117	\$ 5,862	\$ 6,058
Cash flows from investing activities:				
Purchases of mortgages	(65,068)	(31,271)	(123,774)	(59,847)
Proceeds from sales of mortgages	1,388	4,177	3,961	6,895
Mortgage principal repayments	41,872	14,474	65,442	26,314
Net increase in investments	<u>(14,157)</u>	<u>(9,070)</u>	<u>(3,291)</u>	<u>(7,644)</u>
Net cash used in investing activities	<u>(35,965)</u>	<u>(21,690)</u>	<u>(57,662)</u>	<u>(34,282)</u>
Cash flows from financing activities:				
Proceeds from issuance of debt	459,479	286,691	897,899	635,971
Payments to redeem debt	(426,643)	(267,511)	(845,357)	(608,815)
Other	119	(700)	(535)	(1,002)
Net cash provided by financing activities	<u>32,955</u>	<u>18,480</u>	<u>52,007</u>	<u>26,154</u>
Net increase (decrease) in cash and cash equivalents	15	(93)	207	(2,070)
Cash and cash equivalents at beginning of period	809	122	617	2,099
Cash and cash equivalents at end of period	<u>\$ 824</u>	<u>\$ 29</u>	<u>\$ 824</u>	<u>\$ 29</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 accounting principles generally accepted in the United States of America for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America 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 2000 have been reclassified to conform with the current presentation. Operating results for the three- and six-month periods ended June 30, 2001 are not necessarily indicative of the results that may be expected for the year ending December 31, 2001. 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 30, 2001.

Accounting Change

Effective January 1, 2001, Fannie Mae adopted Financial Accounting Standard No. 133 (FAS 133), *Accounting for Derivative Instruments and Hedging Activities*, as amended by FAS 138. FAS 133 requires that all derivatives be recognized as either assets or liabilities on the balance sheet at their fair value. Subject to certain qualifying conditions, a derivative may be designated as either a hedge of the fair value of a fixed-rate instrument (fair value hedge) or a hedge of the cash flows of a variable-rate instrument or anticipated transaction (cash flow hedge). For a derivative qualifying as a fair value hedge, fair value gains or losses on the derivative are recognized in earnings along with the fair value losses or gains on the hedged item attributable to the risk being hedged. For a derivative qualifying as a cash flow hedge, fair value gains or losses on the derivative associated with the risk being hedged are recorded in a separate component of stockholders' equity (other comprehensive income) to the extent they are effective and then recognized into earnings during the period(s) in which the hedged item affects income. For a derivative not qualifying as a hedge, or components of a derivative which are excluded from any hedge effectiveness assessment, fair value gains and losses on the derivative are reported in earnings.

Fannie Mae primarily uses cash flow hedges to hedge its exposure to the variability in cash flows related to anticipated debt issuances and the issuance of its Discount Notes. At June 30, 2001, the maximum length of time that Fannie Mae was hedging anticipatory issuances of fixed-rate debt was 54 days. Changes in the fair value of derivatives designated as and qualifying as cash flow hedges are deferred in other comprehensive income to the extent they are effective. These amounts are subsequently reclassified into interest expense as a yield adjustment in the same period in which the related interest payments on the hedged debt obligations occur. Derivative instruments used as cash flow hedges include, but are not limited to, pay-fixed interest rate swaps and swaptions, caps, simulated short sales of US Treasury securities, and futures contracts. Only changes in the intrinsic value of the options contracts (i.e., pay-fixed swaptions and caps) are deferred in other comprehensive income. Changes in the time value of the option contracts are marked-to-market through current earnings as purchased options income (expense).

Fannie Mae primarily uses fair value hedges to hedge its exposure to changes in fair value related to its long-term fixed-rate debt obligations. Changes in the fair value of the derivatives designated as and qualifying as fair value hedges are recognized in earnings along with any offsetting gain or loss from the hedged debt relative to the risk being hedged. Derivative instruments used as fair value hedges include, but are not limited to, receive-fixed interest rate swaps and swaptions. Only changes in the intrinsic value of the options contracts (i.e., receive-fixed swaptions) are marked-to-market through earnings with an offset from the mark-to-market on the hedged debt relative to the risk being hedged. Changes in the time value of the option contracts are marked-to-market through current earnings as purchased options income (expense).

Upon adoption of FAS 133, investment securities and MBS with an amortized cost of approximately \$20 billion were transferred from held-to-maturity to available-for-sale.

Line of Business Reporting

The following table sets forth Fannie Mae's operating net income, which excludes the effect of FAS 133 items, by line of business for the three- and six-month periods ended June 30, 2001 and 2000. 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>2001</u>			<u>2000</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	\$1,701	\$ 198	\$1,899	\$1,243	\$ 156	\$1,399
Guaranty fee income	(270)	627	357	(263)	602	339
Fee and other income (expense)	37	(12)	25	(38)	(8)	(46)
Credit-related expenses	—	(17)	(17)	—	(21)	(21)
Administrative expenses	(77)	(177)	(254)	(63)	(161)	(224)
Purchased options income (expense) ..	(100)	—	(100)	—	—	—
Federal income taxes	(368)	(136)	(504)	(243)	(140)	(383)
Extraordinary item—loss on early extinguishment of debt (net of tax effect)	(92)	—	(92)	33	—	33
Operating net income	<u>\$ 831</u>	<u>\$ 483</u>	<u>\$1,314</u>	<u>\$ 669</u>	<u>\$ 428</u>	<u>\$1,097</u>

<u>Six Months Ended June 30,</u>	<u>2001</u>			<u>2000</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	\$3,236	\$ 371	\$3,607	\$2,476	\$ 285	\$2,761
Guaranty fee income	(533)	1,233	700	(522)	1,193	671
Fee and other income (expense)	71	(19)	52	(19)	(27)	(46)
Credit-related expenses	—	(47)	(47)	—	(51)	(51)
Administrative expenses	(149)	(345)	(494)	(125)	(316)	(441)
Purchased options income (expense) ..	(164)	—	(164)	—	—	—
Federal income taxes	(703)	(251)	(954)	(508)	(260)	(768)
Extraordinary item—loss on early extinguishment of debt (net of tax effect)	(147)	—	(147)	33	—	33
Operating net income	<u>\$1,611</u>	<u>\$ 942</u>	<u>\$2,553</u>	<u>\$1,335</u>	<u>\$ 824</u>	<u>\$2,159</u>

(1) Certain amounts for 2000 have been reclassified to conform with the allocation method used for 2001.

The Portfolio Investment line of business represented \$724 billion, or 98 percent of total assets, at June 30, 2001 and \$598 billion, or 98 percent of total assets, at June 30, 2000.

Commitments and Contingencies

Fannie Mae had outstanding commitments to purchase mortgages, to issue MBS, and to make other investments as shown below:

	<u>June 30, 2001</u>
	(Dollars in billions)
Commitments to purchase mortgages:	
Mandatory delivery	\$ 38
Lender option(1)	2
Average net yield on mandatory delivery	6.73%
Master commitments:	
Mandatory delivery(2)	\$ 30
Lender option	6
Other investments	2

(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.

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

	<u>June 30, 2001</u>
	(Dollars in billions)
Total MBS(1)	\$1,163
Amount for which Fannie Mae has primary foreclosure loss risk(2)	953
Credit enhancements	10
Other guarantees	5

(1) Includes \$390 billion of MBS held in portfolio and is net of \$607 million in allowance for losses.

(2) Fannie Mae, however, assumes the ultimate risk of loss on all MBS.

Computation of Earnings per Common Share

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

	Three Months Ended June 30,				Six Months Ended June 30,			
	2001		2000		2001		2000	
	Basic	Diluted	Basic	Diluted	Basic	Diluted	Basic	Diluted
	(Dollars and shares in millions, except per common share amounts)							
Net income before extraordinary loss and cumulative effect of change in accounting principle	\$1,495	\$1,495	\$1,064	\$1,064	\$2,675	\$2,675	\$2,126	\$2,126
Extraordinary gain (loss)	(92)	(92)	33	33	(147)	(147)	33	33
Cumulative effect of change in accounting principle	—	—	—	—	168	168	—	—
Preferred stock dividends	(35)	(35)	(32)	(32)	(68)	(68)	(52)	(52)
Net income available to common stockholders	<u>\$1,368</u>	<u>\$1,368</u>	<u>\$1,065</u>	<u>\$1,065</u>	<u>\$2,628</u>	<u>\$2,628</u>	<u>\$2,107</u>	<u>\$2,107</u>
Weighted average common shares	1,001	1,001	1,004	1,004	1,001	1,001	1,009	1,009
Dilutive potential common shares(1)	—	6	—	6	—	6	—	5
Average number of common shares outstanding used to calculate earnings per common share	<u>1,001</u>	<u>1,007</u>	<u>1,004</u>	<u>1,010</u>	<u>1,001</u>	<u>1,007</u>	<u>1,009</u>	<u>1,014</u>
Earnings per common share before extraordinary item and cumulative effect of change in accounting principle	\$ 1.46	\$ 1.45	\$ 1.03	\$ 1.02	\$ 2.61	\$ 2.59	\$ 2.06	\$ 2.05
Net earnings per common share	<u>1.37</u>	<u>1.36</u>	<u>1.06</u>	<u>1.05</u>	<u>2.63</u>	<u>2.61</u>	<u>2.09</u>	<u>2.08</u>

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

MANAGEMENT

The President of the United States has the authority to appoint five directors. In July, the President appointed the following people to Fannie Mae's Board of Directors for a term expiring on the date of the May 2002 annual meeting of stockholders.

Victor H. Ashe, 56, has been the Mayor of the City of Knoxville, Tennessee since 1987. Mayor Ashe is a past President of the United States Conference of Mayors and served as executive director of the Americans Outdoors Commission from July 1985 to January 1987.

Molly H. Bordonaro, 32, is an associate with the commercial real estate service company Norris, Beggs & Simpson. From 1995 to 1999, Ms. Bordonaro was owner and President of The Bordonaro Group, a Portland, Oregon strategic consulting firm specializing in economic and health care issues. Ms. Bordonaro served as a Commissioner on the Commission on the Advancement of Women and Minorities in Science, Engineering and Technology from 1999 to 2000.

William R. Harvey, 60, has been President of Hampton University since 1978. Dr. Harvey is currently a board member of the First Union National Bank (Atlantic Division), Newport News Shipbuilding, Inc. and Trigon Blue Cross Blue Shield of Virginia. He has served on the President's National Advisory Council on Elementary and Secondary Education, the Fund for the Improvement of Postsecondary Education, the Commission on Presidential Scholars and the U.S. Department of Commerce Minority Economic Development Advisory Board.

Taylor C. Segue, III, 47, has been a shareholder in Butzel Long, P.C., a Detroit law firm since 1999. From 1991 to 1999, Mr. Segue was a partner at Segue, Fair, Adams & Pope, P.L.C. Mr. Segue is a board member of the Michigan Education Trust and the American Red Cross Southeast Michigan Blood Services Region.

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